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Petition and Transcript of Record

Supreme Court of the United States

OCTOBER TERM, 1931

No. 348

UNITED STATES CARTRIDGE COMPANY,
PETITIONER,

vs.

THE UNITED STATES

ON WRIT OF CERTIORARI TO THE COURT OF CLAIMS

PETITION FOR CERTIORARI FILED SEPTEMBER 3, 1931

CERTIORARI GRANTED NOVEMBER 23, 1931

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INDEX.

	Original	Print
Petition for writ of certiorari	1	1
Record from Court of Claims	1	15
Petition	1	15
Exhibit "A"—Notice of determination	38	43
Exhibit "B"—Notice and demand	45	48
Exhibit "C"—Agreement between U. S. Cartridge Co. and Fidelity and Deposit Co. of Maryland, October 20, 1917	46	49
Exhibit "D"—Note of October 20, 1917	50	52
Exhibits "E" to "H"—Notices requesting suspension of production under contracts	51	52
Exhibit "I"—Computation of excess profits, war profits, and income taxes of U. S. Cartridge Co., 1918	56	57
General traverse	57	58
Argument and submission	57	58
Special findings of fact	58	58
Conclusion of law	79	88

JUDD & DETWEILER (INC.), PRINTERS, WASHINGTON, D. C., SEPTEMBER 9, 1931

	Original	Print
Opinion, Booth, C. J.	79	88
Exhibits to special findings of fact	96	110
2. Copy of claim of United States Cartridge Company for refund of 1918 taxes, filed January 25, 1927 (special finding 8)	96	110
3. Copy of contract, dated March 19, 1917, between Maxim Munitions Corporation and Officine di Villar Perosa (special finding 9) (omitted in printing)	108	
4. Copy of amendment, dated May 31, 1917, to contract between Maxim Munitions Corporation and Officine di Villar Perosa (special finding 9) (omitted in printing)	116	
5. Copy of amendment, dated December 14, 1917, to contract between Maxim Munitions Corporation and Officine di Villar Perosa (special finding 9) (omitted in printing)	119	
6. Copy of contract, dated October 5, 1917, between United States Cartridge Company and Maxim Munitions Corporation (special finding 9) (omitted in printing)	124	
7. Copy of bond, dated March 22, 1917, from Maxim Munitions Corporation and sureties to Officine di Villar Perosa (special finding 10) (omitted in printing)	138	
10. Copy of conveyance from James G. Graham, receiver in bankruptcy of Maxim Corporation, to United States Cartridge Company, dated July 10, 1919 (special finding 17) (omitted in printing)	140	
11. Copy of conveyance from James G. Graham, trustee in bankruptcy of the Maxim Corporation, to United States Cartridge Company, dated March 16, 1926 (special finding 17) (omitted in printing)	144	
11—Copy of contract, P6489-1489Sa, dated May 6, 1918, between United States Cartridge Company and United States (special finding 21)	163	120
12. Copy of first supplemental contract to contract P6489-1489Sa (special finding 21)	180	132
13. Copy of contract, P12289-3034A, dated July 20, 1918, between United States Cartridge Company and United States (special finding 21)	183	134
14. Copy of contract, GA-126, dated August 22, 1917, between United States Cartridge Company and United States (special finding 21)	196	146
15. Copy of letter, dated November 15, 1917, from purchase section, office of chief of ordnance, to United States Cartridge Company (special finding 21)	215	162

	Original	Print
16. Copy of letter, dated November 28, 1917, from United States Cartridge Company to purchase section, office of chief of ordnance, (special finding 21)	217	163
17. Copy of contract, P12621-3124A, dated July 25, 1918, between United States Cartridge Company and United States (special finding 21)	218	163
6. Copy of partial payment, supplemental contract, dated April 8, 1920, between United States and United States Cartridge Company relating to contract P12289-3034A (special finding 31)	227	174
7. Copy of partial payment, supplemental contract, dated March 27, 1920, between United States and United States Cartridge Company relating to contract GA-126 (special finding 31)	233	180
20 to 24—Statements showing analysis of use of buildings on leaseholds at Lowell and South Lowell, annual rentals, etc. (special finding 57)	239	185
Judgment	246	200
Order entering amount of judgment	246	200
Clerk's certificate (omitted in printing)	248	
Stipulation as to supplemental contract relating to contract No. P12621-3124A	249	201
Stipulation re omission of certain exhibits	250	201
Order allowing certiorari		203

[fol. 1]

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1931

No. 348

UNITED STATES CARTRIDGE COMPANY, Petitioner,

v.

THE UNITED STATES, Respondent

PETITION FOR WRIT OF CERTIORARI TO THE COURT OF CLAIMS

The United States Cartridge Company, a corporation organized under the laws of the Commonwealth of Massachusetts, prays that a writ of certiorari be issued to review a judgment of the Court of Claims entered on the tenth day of June, 1931, in a cause brought by your petitioner in said Court. The decision of the Court of Claims is reported in 48 F. (2d) 983.

Statement of Matters Involved

The petitioner brought suit in the Court of Claims to recover alleged overpayments of its 1918 Federal income [fol. 2] and profits taxes amounting to $843,589.12 and interest. The petitioner's fiscal year was the calendar year. The petitioner's claim was based upon three independent errors alleged to have been made by the Commissioner of Internal Revenue in determining the taxable income of the petitioner for 1918, namely, an error in the valuation of a certain Italian contract inventory at the end of 1918; an error in the valuation at the end of 1918 of certain inventories of the petitioner acquired for use in filling contracts with the United States production under which had been stopped in 1918; and the refusal of the Commissioner to allow a deduction claimed for 1918 on account of the cost of buildings erected by the petitioner on leased land for [illegible]r purposes.

The Court of Claims rendered judgment for the petitioner on June 10, 1931, for $160,978.83 with interest. This judgment represented the amount claimed by the petitioner

on account of the overvaluation of the Italian contract inventory. The Court decided the other items adversely to the petitioner. This petition is brought for the purpose of securing a review by this Court of the two items which were disallowed. The petitioner complied with all requirements with respect to filing claims for refund and with all other formal requirements and the petitioner's right to recover depends only on the question as to how the disputed items should be treated in computing the petitioner's income for [fol. 3] 1918 (Opinion of the Court, pp. 1, 22; record, p. 58, 79).* The facts relating to these items are stated below.

The Deduction on Account of Cost of Buildings Erected on Leased Land

For many years before the World War began in 1914 the petitioner had been engaged in the manufacture of ammunition for small arms to be used for ordinary peace-time purposes. Its business was of a very modest size, employing between 350 and 400 persons. It was carried on principally in buildings at Lowell, Massachusetts, which the petitioner leased from the Wamesit Power Company. The market for the petitioner's product was limited. Its business was highly competitive and was not profitable during the years 1911 to 1914 inclusive, before it began production for war purposes (Special Finding 43, record, p. 70). For the purpose of filling war orders which the petitioner had received, and expected to receive while the war continued, the petitioner, at its own expense, constructed buildings upon land of the Wamesit Power Company at Lowell and at South Lowell, Massachusetts, under an agreement by which the petitioner was entitled to occupy these buildings free of rent for ten years from January 1, 1915, and at the end of the ten years they should become the property of the Wamesit Power Company. The cost of these buildings to [fol. 4] the petitioner was $802,499.49, nearly all of which was spent in 1915 and 1916 (Special Findings 44-45, record, p. 71).

When the petitioner built these buildings it had no use for them except for war purposes. During the World War the petitioner had a large and profitable business in war

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[* References to side folios of printed record.]

ammunition, first, for European governments and, later, for the United States. Its employees increased to about 15,000, and the space occupied was about five times what had been required before the war. The petitioner used all the buildings which it had constructed on leased land up to the time when the United States entered the war and during the years 1917 and 1918. Up to the time of the Armistice, November 11, 1918, the petitioner had orders up to its capacity and had no way of knowing when the demand for war ammunition would stop. After the Armistice, the petitioner received no new orders for military ammunition, did not expect any, and did not expect to continue production of military ammunition to any material extent (Special Findings 46-47, record, p-. 71-72).

After the Armistice the petitioner continued its commercial ammunition business. Its position with respect to this business was difficult, as each of the five munition manufacturers in the country had a large excess capacity. The peace-time business differed in essential respects from the war business. The war business came to the manufacturer. There was no selling to be done. Production was confined [fol. 5] to a few types in large volume. In the commercial ammunition business, both in the pre-war and post-war periods, there were a large number of kinds of articles made for all varieties of arms. Competition was severe and keen and the industry was believed to be declining. After 1918 the petitioner made no profit in its manufacture of commercial ammunition during any of the years included in the period of the lease (Special Findings 50-52, record, p-. 73-74).

No income could be derived by renting the new buildings, as there was no demand for them. Most of the buildings rented from the Wamesit Power Company had been so incorporated into the new buildings that the two had to be used as united unless the plant was revamped and this was not considered or done. The petitioner had in the new buildings and in those which it rented more spaces than it needed for its commercial ammunition business. In an attempt to utilize the space which the petitioner found on its hands, it undertook the manufacture in the buildings in question (except the garage) of certain articles which it had not made before the war, including radiators, radiator tubes, phonograph motors, paper boxes and certain other

articles, in addition to commercial ammunition. The volume of this new business was small compared with the petitioner's commercial ammunition business. The petitioner made no profit from these other businesses but suffered a loss in each year (Special Finding 51, record, p. 74).

[fol. 6] Among the buildings in question was a garage which the petitioner built for the trucks and automobiles used in its war business. It had no need for the garage before or after its war business. After the war the petitioner attempted to operate this building as a public garage but realized no net return. It was rented to others from October, 1923, until the end of the lease, a period of fifteen months (Special Finding 56, record, p. 75).

The Commissioner of Internal Revenue allowed depreciation for the years 1914-1917 inclusive on account of the cost of these buildings, amounting in all to $197,107.74. The depreciated cost of the buildings at the end of 1917 was $605,391.75 (cost, $802,499.49, less depreciation, $197,-107.74). In the settlement of its 1918 income and profits taxes, the petitioner claimed that the value on December 31, 1918, of its right to use these buildings for peace-time purposes for the remainder of the lease was $190,969.86. The Court of Claims has found that the value on December 31, 1918, of such right to use the buildings did not exceed this amount (Special Finding 53, record, p. 74). The petitioner claimed that it was entitled to deduct for the year 1918 the difference between the depreciated cost of said buildings at the end of 1917, $605,391.75, and the residual value at the end of 1918, $190,969.86, making a deduction of $414,421.89 for the year 1918. The Commissioner of In-[fol. 7] ternal Revenue refused to allow any deduction for loss of useful value of these buildings, ruling that the petitioner was not entitled to it because it had not abandoned the use of the buildings or permanently devoted them to a radically different use. The Commissioner allowed a deduction of $86,484.54 for the year 1918 on account of the cost of these buildings and disallowed the remainder of the petitioner's claim, namely $327,937.35. Said allowances for depreciation of $197,107.74 and $86,484.54, were reached by calculating it at such a rate that at the expiration of the

lease the cost of each building would be extingished in equal annual instalments (Special Finding 49, record, p. 72).

As the petitioner had income for the year 1918 outside the disputed items sufficient to use up its excess profits and war profits tax credits, the effect of the disallowance by the Commissioner of $327,937.35 of the deduction claimed was to increase the petitioner's taxes for 1918 by 82.4% of that amount. (See Special Findings 3-6, record, p. 59.)

In its income tax returns for the years 1919-1924, which were the remaining years of the lease, the petitioner claimed deductions on account of the buildings in question amounting in all to $190,969.86, which was the residual value on December 31, 1918, of the right to use the buildings during the remainder of the lease. The Commissioner of Internal Revenue, in determining the taxes of the petitioner for the [fol. 8] years 1919-1924 increased the deductions claimed by the petitioner for those years by the $327,937.35 which he had disallowed for the year 1918 (Special Finding 49, record, p. 72). The effect of this was to throw this deduction into the years in which the petitioner, if it had any taxable income, would be taxed at relatively low rates and to deprive the petitioner of it for the year 1918 when it made a difference in taxes of 82.4% of the deduction.

The Court of Claims sustained the Commissioner (Opinion of the Court, record pp. 87-93).

The Inventories Acquired for Use under Contracts with the United States

The petitioner kept its accounts on an accrual basis and duly elected that its inventories should be priced at cost or market whichever was lower (Special Findings 2-3, record, p. 58-59).

At the end of the year 1918 the petitioner had on hand a large quantity of raw materials and work in process which had been acquired by the petitioner for use in manufacturing ammunition to be supplied to the War Department under four contracts and a supplementary agreement which are described in Special Finding 21 of the Court below (record, p. 64). Copies of the contracts and agreement (hereinafter called "contracts") are included in the record (pp. 163-226). A list of the contracts follows:

[fol. 3]

Contract No.	Date		Articles to be delivered
P6489-1489Sa.....	May 6, 1918	60,100,000	.45 caliber cartridges
First supplement to P6489-1489Sa....	.....	75,000,000	do.
P12289-3034A.....	July 20, 1918	8,760,000	49-gr. artillery primers
GA-126.....	Aug. 22, 1917	5,000,000	110-gr. do.
P12621-3124A.....	July 25, 1918	1,000,000	110-gr. do.

The issue which arose as to these inventories was whether they should be valued at their market value on December 31, 1918 ($231,613.43), or at the amount fixed by the Commissioner of Internal Revenue in his determination of the petitioner's taxes which was made in 1925 ($732,088.62). The Commissioner's valuation represented what the petitioner eventually realized from these inventories largely as a result of negotiated settlements with the United States made in the years 1920-1922.

Each of the contracts in question contained a cancellation clause by which the Chief of Ordnance had an option to cancel the contract if in his opinion the completion of it became unnecessary. In that event the contracts gave the petitioner certain rights, including the right to receive payment at cost for raw materials and work in process on hand. Under each of these contracts, except the supplement to P6489-1489Sa and GA-126, the petitioner also had the right, if the Chief of Ordnance exercised the option given by the cancellation clause, to continue to manufacture for thirty days after notice of cancellation, and under contract GA-126 it had the right to convert the contract [fol. 10] into a cost plus contract. (See Special Finding 21, record, p. 64; copies of contracts P6489-1489Sa, article V; P12289-3034A, article XIV; P12621-3124A, article XIV; GA-126, article VII, record, pp. 170, 190, 203, 223.)

The Chief of Ordnance did not exercise these options to cancel. Instead of exercising the rights given by the cancellation clauses, he sent to the petitioner written requests (called "suspension requests") to suspend production under the respective contracts with a view to settlements by negotiation. Each suspension request contained substantially the following language:

"This request is made with a view to negotiation of a supplemental contract providing for the cancellation, settlement and adjustment of your existing contract in a

manner which will permit of a more prompt settlement and payment than will be practicable under the terms of said existing contract."

Copies of these requests are annexed to the petition filed in the Court of Claims (exhibits E, F, G, H, record, pp. 51-55). The petitioner received these requests in December, 1918, and complied with them and suspended production under all the contracts (Special Finding 22, record, p. 65).

On December 31, 1918, the petitioner had on hand material and work in process, constituting the inventories in question, which had been acquired and worked for the purpose of manufacturing the articles specified in these contracts, and which, because of such suspension requests, [fol. 11] would not be required in making completed articles (Special Finding 23, record, p. 65). It was not possible for the petitioner to use such inventories advantageously by manufacturing them into the articles for which they had been intended as there was no market for such articles. There was no way in which the petitioner could get back what the inventories had cost, except by settlements with the United States. The material in these inventories was not salable at any price approaching cost (Special Finding 24, record, p. 66).

The petitioner contended that this material and work in process should be valued as of December 31, 1918, at its market value, which was $231,615.43 (Special Findings 41-42, record, p. 70). In the year 1925, the Commissioner of Internal Revenue, in determining the petitioner's taxable income for 1918, valued this material and work in process at $732,088.62. This amount was a composite figure, made up of three elements, (1) cost for such portions of the inventory as were taken over at cost by the United States as a result of various settlement contracts which were made after 1918, (2) the amount received in such settlements for certain material which was paid for at less than cost, and (3) the fair market value on December 31, 1918, for such material only as was not taken over in the settlements (Special Finding 41, record, p. 70). By valuing said inventories at $732,088.62, instead of their market value ($231,615.43), the Commissioner of Internal Rev-

enue increased the apparent taxable income of the peti-
[fol. 12] tioner for 1918 by $500,473.19 and thereby increased the petitioner's taxes by 82.4% of this amount.

That the prospects as to whether the petitioner would obtain settlements of its contracts were wholly uncertain at the end of 1918 appears from the history of the negotiations which led up to the settlements of 1920-1922. The details of this history are contained in Special Findings 25-40, record, p-. 66-70. A condensed statement follows.

During the year 1918 no settlement was made of any of said contracts and no negotiations took place other than the suspension requests. No policy was adopted by the War Department which permitted a settlement for an inventory under a suspended contract where the parties could not agree upon the settlement of the contract as a whole, until March 6, 1919. The petitioner had substantial claims under each contract for items other than inventories which remained unsettled until the time of the final settlements of the respective contracts. The first final settlement was made in December, 1921 (Special Findings 25-27, record, p. 66).

In February, 1919, the Ordnance Department assigned a committee to the petitioner's plant for the purpose of settling its contracts. The petitioner negotiated with this committee and other Government agencies which subsequently took over its work with the result that agreements were made in the year 1920 that the United States would take over and pay for most of the petitioner's inventories of raw material and work in process. In the year 1920 [fol. 13] the United States took over the greater part of such materials and paid for them at cost, excepting the cost of labor and overhead on the material in process (Special Findings 28-33, record, p-. 66-67). There were at the time many unsettled differences between the parties as to the amounts to be allowed for such labor and expenses. There were also certain inventory items which the United States would not at the time accept or pay for. In the final settlements in 1921 and 1922, the United States agreed to pay for some of these items and declined on various grounds, to reimburse the petitioner for any loss on account of others. In some cases a compromise was made by which the petitioner was reimbursed for a part

of the cost of certain items, and received no reimbursement for the balance (Special Findings 33-34, record, p. 67).

The preparation and presentation of the petitioner's claims under its various war contracts in accordance with the requirements of the War Department, and the Government audit of those claims, required a large amount of work extending over several years. The petitioner had claims against the United States under war contracts other than those described above, including a cost plus contract (known as No. 14066) which was much larger than the contracts described above taken together. The petitioner at times employed as many as thirty-five or forty persons [fol. 14] on its claims and spent approximately $400,000, exclusive of legal expenses, in meeting the requirements of the War Department as to the proof of its claims under its various contracts including, among others, contract 14066 and the contracts involved in the present case (Special Finding 35, record, p. 68.)

A number of obstacles in the way of the settlement of some or all of the petitioner's contracts appeared during the negotiations. One of these related to contract P6489-1489Sa, which was by far the most important contract involved. (See Special Finding 38, record, p. 69.) That contract had been modified by a supplemental agreement by which the quantity of cartridges to be delivered had been increased and the specifications in the original contract had been somewhat changed. The original contract was a properly executed written agreement which complied with Revised Statutes, § 3744, but the supplemental agreement was not. The War Department treated the original contract, as amended, as one not executed in accordance with law. The difficulty with respect to payment for undelivered material which would have resulted from this ruling was removed by the Dent Act (40 Stat. 1272) which was passed on March 2, 1919, and contract P6489-1489Sa and its supplement were settled under procedure established to cover contracts not executed in accordance with law (Special Finding 30, record, p. 66).

[fol. 15] Other obstacles which arose to the successful completion of negotiations for settlement of the petitioner's contracts are stated in detail in the findings of the Court

below (Special Findings 33-34, 36-37, record, p. 67-68). These included the probability that the War Department agencies which were dealing with the petitioner's claims would be dissolved before these claims could be presented; and the probability that no appropriations which could be used for payment of claims under suspended contracts would be available long enough to permit the payment of the petitioner's claims, with the exception of a claim for cost of unworked materials under contract P6489-1489Sa, which was settled and paid for in January, 1920, while appropriations were expected to be available (Special Findings 32, 36-37, record, p. 68). As it turned out, the agencies of the War Department for the settlement of claims under suspended contracts were continued, and Congress renewed the appropriations for payment of such claims, so that the War Department was able to make the final settlements and to pay the petitioner for its inventories in accordance with them.

After the final settlement contracts were made in 1921 and 1922, the United States still withheld $52,591.05 of the amount agreed to be paid under two of these contracts, and applied it to an alleged overpayment for finished goods under one of the contracts. In 1926, the petitioner recovered this amount as the result of a suit in the Court of [fol. 16] Claims (Special Finding 39, record, p. 69).

The Court of Claims sustained the Commissioner in valuing the petitioner's inventories at $732,088.62 instead of at their market value ($231,615.43). In reaching this conclusion the Court below relied on the provisions of the cancellation clauses in the original contracts, holding that these clauses constituted positive covenants to pay the petitioner the cost of the inventories (Opinion of the Court, record, p. 79 at p. 85-87). The Court also held that the Commissioner of Internal Revenue had the right to treat the amounts which were realized for the inventories through the settlement contracts as the true value of the inventories at the end of the year 1918 which had been determined in the light of later facts. In support of this conclusion the Court relied upon the case of Producers' Fuel Co., 1 B. T. A. 202, as applicable in principle to the case at bar (record, p. 87).

Assignments of Errors to be Urged

The petitioner contends that the Court below erred in the following respects:

1. The Court below erred in not allowing the petitioner the deduction of $327,937.35 from its gross income for 1918 on account of the cost of buildings erected by the petitioner on leased land, in addition to the deduction of $86,484.54 which was allowed by the Commissioner of Internal Revenue.

[fol. 17] 2. The Court below erred in denying to the petitioner a deduction from its gross income for the year 1918 on account of the cost of buildings erected by it on leased land in addition to the deduction of $86,484.54 allowed by the Commissioner of Internal Revenue.

3. The Court below erred in refusing to rule that in determining the petitioner's income for the year 1918, the inventories of the petitioner on hand at the end of that year, which the petitioner had acquired for use under its contracts with the United States which had been suspended, should be valued at their market value on December 31, 1918.

Reasons for the Allowance of the Writ

The decision of the Court of Claims with respect to the deduction for cost of buildings erected for war purposes on leased land is in conflict with the decision of this Court in Burnet v. Niagara Falls Brewing Co., 282 U. S. 648. In Burnet v. Niagara Falls Brewing Co. this Court held that the use of brewery buildings for manufacturing near beer did not prevent an allowance for obsolescence on account of national prohibition, but that such use was in the nature of salvage.

In the case at bar the war business for which the petitioner's buildings were built ended suddenly in 1918 on account [fol. 18] of the Armistice. The use which the petitioner made of them after 1918 was not that for which they were built, and the full value of such use has been credited in making up the petitioner's claim. The Court of Claims held that this use after 1918 was a bar to any deduction for that year in excess of the one made by the Commissioner of Internal Revenue, which took no account of the change

which resulted from the Armistice. The Court below has treated Burnet v. Niagara Falls Brewing Co. as limited to cases in which use of buildings for the original purposes has been prohibited by law. Such a limitation of the Niagara Falls Brewing Co. case is not consistent with the opinion of this Court, in which prohibitory statutes are treated as only one illustration of obsolescence, and loss of trade is treated as another. See Burnet v. Niagara Falls Brewing Co., 282 U. S. 648 at 654. It is of great importance to taxpayers generally that it should be settled by a decision of this Court whether the principle of Burnet v. Niagara Falls Brewing Co. should be so limited, or whether it applies to any case where buildings constructed for a particular purpose cease to be useful for that purpose because of the disappearance of all demand for the goods which they were constructed to produce, and the buildings, in order that they may yield some return, must be used for a much less valuable purpose.

The opinion of the Court below also fails to give effect to the provisions of section 234(a) of the Revenue Act [fol. 19] of 1918. The material portions of this section read as follows:

"Sec. 234. (a) That in computing the net income of a corporation subject to the tax imposed by section 230 there shall be allowed as deductions * * *

(4) Losses sustained during the taxable year and not compensated for by insurance or otherwise; * * *

(7) A reasonable allowance for the exhaustion, wear and tear of property used in the trade or business, including a reasonable allowance for obsolescence;"

There is nothing in the section that imposes any condition that such property must be abandoned or permanently devoted to a radically different use. The Commissioner of Internal Revenue was, therefore, not warranted in denying relief to the petitioner on the ground that such a condition had not been complied with, and the Court of Claims was in error in sustaining the Commissioner of Internal Revenue in this respect.

The decision of the Court of Claims with respect to the valuation of the petitioner's inventories which were in-

tended for use under its United States contracts involves a general question of great importance to all taxpayers who use inventories in ascertaining their annual income. This question is whether inventories should be valued at their market value in the light of facts existing at the end of the tax year, or whether the Commissioner of Internal Revenue has the right to value them in the light of events which happen in subsequent years in consequence of which a price is obtained for them greater than such market value. This question has not been directly decided by this Court. The line of reasoning by which the Court of Claims reached the [fol. 20] conclusion that the inventory might be valued according to what was realized for it in subsequent years is, however, in conflict with decisions of this Court.

The decision of the Court below is in conflict with the decision of this Court in College Point Boat Corporation v. United States, 267 U. S. 12. The Court below held that under the terms of the cancellation clauses in the contracts with the United States, the petitioner became entitled during the year 1918 to be paid for its inventories at cost. In the case of College Point Boat Corporation v. United States it appeared that Government representatives stated to the plaintiff, which had a contract to supply mats to the United States, that on account of the Armistice the mats would probably not be needed and that the Department desired to negotiate for a cancellation of the contract, and requested that production be stopped. It was held that this was not an election to cancel under the terms of a statute giving such a right; and that if the proposed negotiations failed, the defendant committed an anticipatory breach of the contract by stopping the work. The suspension requests in the case at bar are in all essential respects the same as those in the College Point Boat Corporation case. (See exhibits E, F, G and H, record, pp. 54-55.) These suspension requests cannot, consistently with that decision, be treated as bringing the cancellation clauses of the petitioner's contracts into operation, and the Court of Claims was manifestly in error in treating the rights of the parties as arising under these clauses.

[fol. 21] The conclusion of the Court of Claims that the inventories might properly be valued in 1918 according to the amounts received for them in the settlements made in the years 1920-1922, is inconsistent with the evident pur-

claimed from the United States after allowing all just credits and offsets.

3. The petitioner was engaged in the year 1918 in the manufacture of ammunition, chiefly for small arms. The petitioner's accounts were kept upon a calendar year basis. The petitioner filed its income and profits tax returns for the year 1918 on December 15, 1919. Thereafter the Commissioner, acting under the Revenue Act of 1918, assessed income and profits taxes for said year upon the petitioner in the amount of $509,209.29. The petitioner had, prior to December 15, 1919, filed tentative returns of its taxable income for the year 1918 and had paid to the Collector of Internal Revenue at Boston sums on account of its estimated 1918 taxes amounting to $900,000. Of this amount $300,000 was paid on March 15, 1919, $300,000 on June 14, 1919, and $300,000 on September 13, 1919. $509,209.29 of such payments was applied in payment of said assessment for the year 1918, and the balance, namely $390,790.71, was eventually applied in part payment of taxes assessed for the year 1919.

4. On or about December 4, 1925, the Commissioner, after having caused an examination to be made of the petitioner's books, records and income tax returns for 1918, gave writ- [fol. 3] ten notice to the petitioner of his determination that the total income and profits taxes of the petitioner for the year 1918 should be $1,152,123.53, and that an additional tax of $642,914.24 should be assessed over and above the assessment previously made, amounting to $509,209.29, which is described above. A copy of such notice, together with that portion of the schedules thereto annexed which relates to the taxable year 1918, is hereto annexed marked Exhibit A and made a part hereof. In reaching such determination the Commissioner, against the objection of the petitioner, placed certain valuations upon the petitioner's inventories at the end of the year 1918 which were greater than those then and now claimed by the petitioner to be correct, and declined to allow a certain deduction from income for said year which was claimed by the petitioner, and consequently assessed taxes upon the petitioner for said year largely in excess of what such taxes would have been except for such action by the Commissioner. The facts

with respect to these matters in controversy are more fully stated below.

5. On or about January 16, 1926, the Commissioner assessed upon the petitioner additional income and profits taxes for said year 1918 amounting to $642,914.24. Certain overpayments of taxes made by the petitioner for the years 1917 and 1919, amounting to $412,563.90, were applied upon said additional assessment. The Collector of Internal Revenue at Boston on or about March 24, 1926, demanded payment of the balance of said additional assessment amounting to $230,350.34. A copy of such demand is hereto annexed marked Exhibit B and made a part hereof. The petitioner on March 31, 1926, paid said sum of $230,350.34 to said Collector under protest.

[fol. 4] 6. The petitioner had on hand at the end of the year 1918 a large quantity of materials and work in process which had been intended for use in manufacturing munitions for war purposes. Before the end of the year 1918 the petitioner knew that the Armistice had been declared, and had stopped its manufacture of munitions to such an extent that its officers knew that the materials and work in process in question would not be used to make completed articles. The petitioner, in accordance with the provisions of the revenue laws and the regulations made pursuant thereto, duly elected to take its inventory at the end of the year 1918 on the basis of the cost of the goods or the market value thereof, whichever was lower. Such basis was authorized and established by Section 203 of the Revenue Act of 1918 and by Articles 1582, 1583 and 1584 of Regulations 45, made and promulgated by the Commissioner with the approval of the Secretary of the Treasury. Said Section 203 provided as follows:

"That whenever in the opinion of the Commissioner the use of inventories is necessary in order clearly to determine the income of any taxpayer, inventories shall be taken by such taxpayer upon such basis as the Commissioner, with the approval of the Secretary, may prescribe as conforming as nearly as may be to the best accounting practice in the trade or business and as most clearly reflecting the income."

The portions of said Regulations which are material to the questions raised by this petition read as follows:

"Art. 1582. Valuation of Inventories.—Inventories should be valued at (a) cost or (b) cost or market whichever is lower. Whichever basis is adopted must be applied to each item and not merely to the total of the inventory; that is, if for instance basis (b) is adopted, the value of [fol. 5] each item in the inventory will be measured by market if that is lower than cost, or by cost if that is lower than market. A taxpayer may, regardless of his past practice, adopt the basis of cost or market, whichever is lower, for his 1918 inventory, provided a disclosure of the fact and that it represents a change is made in the return. Thereafter changes can be made only after permission is secured from the Commissioner. But see article 1585 for inventories by dealers in securities. Inventories should be recorded in a legible manner and properly computed and summarized, and should be preserved as a part of the accounting records of the taxpayer. Goods taken in the inventory which have been so intermingled that they cannot be identified with specific invoices will be deemed to be the goods most recently purchased.

"Art. 1583. Inventories at Cost.—Cost means:

(1) In the case of merchandise purchased, the invoice price less trade or other discounts except strictly cash discounts approximating a fair interest rate, which may be deducted or not at the option of the taxpayer provided a consistent course is followed. To this net invoice price should be added transportation or other necessary charges incurred in acquiring possession of the goods.

(2) In the case of merchandise produced by the taxpayer, (a) the cost of raw materials and supplies entering into or consumed in connection with the product, (b) expenditures for direct labor, (c) indirect expenses incident to and necessary for the production of the particular article, including in such indirect expenses a reasonable proportion of management expenses, but not including any cost of selling or return on capital whether by way of interest or profit. In any industry in which the usual rules for computation of cost of production are inapplicable, costs may be approximated upon such basis as may be rea-

[fol. 6] sonable and in conformity with established trade practice in the particular industry.

"Art. 1584. Inventories at Market.—Market means the current bid price prevailing at the date of the inventory for the particular merchandise, and is applicable to goods purchased and on hand and to basic materials in goods in process of manufacture and in finished goods on hand, exclusive, however, of goods on hand or in process of manufacture for delivery upon firm sales contracts at fixed prices entered into before the date of the inventory. Where no open market quotations are available the taxpayer must use such evidence of a fair market price at the date or dates nearest the inventory as may be available to him, such as specific transactions in reasonable volume entered into in good faith, or compensation paid for cancellation of contracts for purchase commitments. The burden of proof will rest upon the taxpayer in each case to satisfy the Commissioner of the correctness of the prices adopted. It is recognized that in the latter part of 1918, by reason among other things of governmental control not having been relinquished, conditions were abnormal and in many commodities there was no such scale of trading as to establish a free market. In such a case, when a market has been established during the succeeding year, a claim may be filed for any loss sustained in accordance with the provisions of section 214 (a) (12) or section 234 (a) (14) of the statute. See articles 261-268."

Subsequently and before the determination of the petitioner's taxes for the year 1918, said Articles were amended by Articles 1582, 1583, and 1584 of Regulations 62 and by Articles 1612, 1613, and 1614 of Regulations 65. Articles 1612, 1613, and 1614 of Regulations 65 were in force at the date of the determination and assessment of the additional taxes upon the petitioner for the year 1918 [fol. 7] hereinabove described, having been made and promulgated by the Commissioner of Internal Revenue with the approval of the Secretary of the Treasury on October 6, 1924. Said Articles provided as follows:

"Art. 1612. Valuation of Inventories.—The Act provides two tests to which each inventory must conform: (1) It must conform as nearly as may be to the best accounting practice in the trade or business, and (2) it must clearly

reflect the income. It follows, therefore, that inventory rules can not be uniform but must give effect to trade customs which come within the scope of the best accounting practice in the particular trade or business. In order clearly to reflect income, the inventory practice of a taxpayer should be consistent from year to year, and greater weight is to be given to consistency than to any particular method of inventorying or basis of valuation so long as the method or basis used is substantially in accord with these regulations. An inventory that can be used under the best accounting practice in a balance sheet showing the financial position of the taxpayer can, as a general rule, be regarded as clearly reflecting his income.

"The basis of valuation most commonly used by business concerns and which meets the requirements of the Revenue Act is (a) cost or (b) cost or market, whichever is lower. (For inventories by dealers in securities, see article 1615.) Any goods in an inventory which are unsalable at normal prices or unusable in the normal way because of damage, imperfections, shop wear, changes of style, odd or broken lots, or other similar causes, including second-hand goods taken in exchange, should be valued at bona fide selling prices less cost of selling whether basis (a) or (b) is used, or if such goods consist of raw materials or partly finished goods held for use or consumption, they shall be valued upon a reasonable basis, taking into consideration the [fol. 8] usability and the condition of the goods, but in no case shall such value be less than the scrap value. Bona fide selling price means actual offering of goods during a period ending not later than 30 days after inventory date. The burden of proof will rest upon the taxpayer to show that such exceptional goods as are valued upon such selling basis come within the classifications indicated above, and he shall maintain such records of the disposition of the goods as will enable a verification of the inventory to be made.

"In respect to normal goods whichever basis (a) or (b) is adopted must be applied with reasonable consistency to the entire inventory. Taxpayers were given an option to adopt the basis of either (a) cost, or (b) cost or market, whichever is lower, for their 1920 inventories. The basis adopted for that year is controlling and a change can now be made only after permission is secured from the Commissioner. Goods taken in the inventory which have been so

intermingled that they can not be identified with specific invoices will be deemed to be either (a) the goods most recently purchased or produced, and the cost thereof will be the actual cost of the goods purchased or produced during the period in which the quantity of goods in the inventory has been acquired, or (b) where the taxpayer maintains book inventories in accordance with a sound accounting system in which the respective inventory accounts are charged with the actual cost of the goods purchased or produced and credited with the value of goods used, transferred, or sold, calculated upon the basis of the actual cost of the goods acquired during the taxable year (including the inventory at the beginning of the year) the net value as shown by such inventory accounts will be deemed to be the cost of the goods on hand. The balances shown by such book inventories should be verified by physical inventories at reasonable intervals and adjusted to conform therewith.

"Inventories should be recorded in a legible manner, [fol. 9] properly computed and summarized, and should be preserved as a part of the accounting records of the taxpayer. The inventories of taxpayers on whatever basis taken will be subject to investigation by the Commissioner, and the taxpayer must satisfy the Commissioner of the correctness of the prices adopted.

"The following methods, among others, are sometimes used in taking or valuing inventories, but are not in accord with these regulations, viz.:

(a) Deductions from the inventory a reserve for price changes, or an estimated depreciation in the value thereof.

(b) Taking work in process, or other parts of the inventory, at a nominal price or at less than its proper value.

(c) Omitting portions of the stock on hand.

(d) Using a constant price or nominal value for a so-called normal quality of materials or goods in stock.

(e) Including stock in transit, either shipped to or from the taxpayer, the title of which is not vested in the taxpayer.

"Art. 1613. Inventories at Cost.—Cost means:

(1) In the case of merchandise on hand at the beginning of the taxable year, the inventory price of such goods.

(2) In the case of merchandise purchased since the beginning of the taxable year, the invoice price less trade or other discounts, except strictly cash discounts, approximating a fair interest rate, which may be deducted or not at the option of the taxpayer, provided a consistent course is followed. To this net invoice price should be added transportation or other necessary charges incurred in acquiring possession of the goods.

(3) In the case of merchandise produced by the taxpayer since the beginning of the taxable year (a) the cost of raw materials and supplies entering into or consumed in [fol. 10] connection with the product, (b) expenditures for direct labor, (c) indirect expenses incident to and necessary for the production of the particular article, including in such indirect expenses a reasonable proportion of management expenses, but not including any cost of selling or return on capital, whether by way of interest or profit.

(4) In any industry in which the usual rules for computation of cost of production are inapplicable, costs may be approximated upon such basis as may be reasonable and in conformity with established trade practice in the particular industry. Among such cases are (a) farmers and raisers of live stock (see article 1616), (b) miners and manufacturers who by a single process or uniform series of processes derive a product of two or more kinds, sizes or grades, the unit cost of which is substantially alike (see article 1617), and retail merchants who use what is known as the 'retail method' in ascertaining approximate cost (see article 1618).

"Art. 1614. Inventories at Market.—Under ordinary circumstances, and for normal goods in an inventory 'market' means the current bid price prevailing at the date of the inventory for the particular merchandise in the volume in which usually purchased by the taxpayer, and is applicable in the cases (a) of goods purchased and on hand, and (b) of basic elements of cost (materials, labor, and burden) in goods in process of manufacture and in finished goods on hand; exclusive, however, of goods on hand or in process of manufacture for delivery upon firm sales contracts (i. e., those not legally subject to cancellation by either party) at fixed prices entered into before the date of the inventory, which goods must be inventoried at cost. Where no open

market exists or where quotations are nominal, due to stagnant market conditions, the taxpayer must use such evidence of a fair market price at the date or dates nearest the inventory as may be available, such as specific purchases or [fol. 11] sales by the taxpayer or others in reasonable volume and made in good faith, or compensation paid for cancellation of contracts for purchase commitments. Where the taxpayer in the regular course of business has offered for sale such merchandise at prices lower than the current price as above defined, the inventory may be valued at such prices less proper allowance for selling expense, and the correctness of such prices will be determined by reference to the actual sales of the taxpayer for a reasonable period before and after the date of the inventory. Prices which vary materially from the actual prices so ascertained will not be accepted as reflecting the market."

The articles, the value of which is in question in this case, were manufactured or intended for use under two classes of contracts, one a contract for nine-millimeter cartridges to be used by the Kingdom of Italy, and the other, several contracts with the United States for cartridges and for artillery primers. The facts relating to these contracts are stated below, those relating to the contract for nine-millimeter cartridges in Paragraphs 7 to 14 and those relating to the contracts with the United States in Paragraphs 15 to 17.

7. Among the goods owned by the petitioner at the end of the year 1918, there were a large number of manufactured and partly manufactured nine-millimeter cartridges and a large quantity of materials for the manufacture of the same. These articles had been in process of manufacture by the petitioner in 1918 for the purpose of making deliveries of nine-millimeter cartridges under a contract between the petitioner and the Maxim Munitions Corporation, a corporation organized under the laws of the State of Delaware. The Maxim Munitions Corporation on March 19, 1917, had contracted to sell 250,000,000 [fol. 12] of such completed cartridges to Officine di Villar Perosa, a corporation organized under the laws of the Kingdom of Italy, hereinafter called the Purchaser, and to deliver the same in instalments. The petitioner had

contracted with the Maxim Munitions Corporation on October 5, 1917, to furnish the cartridges for such delivery at stipulated prices to be paid by the Maxim Munitions Corporation to the petitioner. The Maxim Munitions Corporation also agreed to give to the petitioner from time to time orders upon the Purchaser to collect the amounts to be paid to the petitioner by the Maxim Munitions Corporation upon delivery of such cartridges, and as security for the giving of such orders assigned to the petitioner the right, title and interest of the Maxim Munitions Corporation in any moneys to which it might become entitled on account of cartridges to be manufactured and delivered in fulfilment of its contract with the Purchaser. Said nine-millimeter cartridges were purchased by the Purchaser for use by the Kingdom of Italy in the war in which it was then engaged with the governments of Germany and Austria. Under instructions received from the Purchaser and assented to by the Maxim Munitions Corporation, all matters relating to the inspection and acceptance of cartridges on behalf of the Purchaser were handled in the year 1918 by representatives of the Kingdom of Italy. Inspection of said cartridges was made regularly by representatives of the said Kingdom of Italy at the plant of the petitioner, and shipping directions were in the regular course of business given to the petitioner by such representatives. Certain amendments had been made on December 14, 1917, to the contract between the Purchaser and the Maxim Munitions Corporation by which the total number of nine-millimeter cartridges to be de- [fol. 13] livered under said contract was fixed at 125,000,000, and delivery thereof was to be made in accordance with a schedule of monthly quantities under which the last delivery to complete the contract was to be made in May, 1918. The petitioner, on account of the requisitioning of its facilities by the United States, was not able to complete the deliveries according to this schedule, but the Maxim Munitions Corporation and the representatives of the Kingdom of Italy continued to accept deliveries until some time in the month of November, 1918.

8. In November, 1918, hostilities came to an end in the war in which the Kingdom of Italy was then engaged. On November 22, 1918, Camillo Cerruti, who was then in charge

on behalf of the Kingdom of Italy of all matters relating to the delivery and acceptance of said cartridges, notified the Maxim Munitions Corporation that the contract between that corporation and the Purchaser must be considered cancelled on account of the failure of the Maxim Munitions Corporation to keep the terms of delivery under the contract. A question was raised as to the authority of Mr. Cerruti to cancel the contract on behalf of the Purchaser, and on November 26, 1918, the Purchaser, through Joseph S. Jacobs, its duly authorized agent, requested the Maxim Munitions Corporation to discontinue the manufacture of cartridges without prejudice to any rights which the Maxim Munitions Corporation might have by reason of the request, and without prejudice to the rights of either party under the contract. The Maxim Munitions Corporaton then requested the petitioner to discontinue the manufacture of the cartridges. The manufacture of such cartridges was accordingly stopped by the petitioner [fol. 14] on November 26, 1918. At that date the number of such cartridges which had been delivered was 8[illegible],460,000. The petitioner had on hand on November 26, 1918, upwards of 4,000,000 completed nine-millimeter cartridges which had not been delivered and a large quantity of parts for such cartridges and materials for the manufacture of the same. On account of the Armistice which had been declared it was wholly improbable that the Kingdom of Italy would have any use for additional cartridges of this type. The cartridges in question were made for use in small arms adopted by the Kingdom of Italy for war purposes but were not of a size which was in use for other purposes. The petitioner had no customers for such cartridges other than the Maxim Munitions Corporation or the Kingdom of Italy. The petitioner had notice of the facts stated in this eighth paragraph before the end of the year 1918.

9. Before the end of the year 1918 the Maxim Munitions Corporation had become wholly insolvent and unable to perform its contract with the petitioner, and the petitioner had learned of these facts. There was no reason to expect at the end of the year 1918 that the Maxim Munitions Corporation would accept and pay for the completed nine-millimeter cartridges which the petitioner had on hand,

pose of the Revenue Act of 1918. This Act imposed taxes running up to 82.4% of a taxpayer's income which were payable in instalments in the year 1919. The income intended to be taxed at such a rate must, in reason, be something which, according to ordinary business practice has been realized so that it is available for the purpose of paying the taxes. In the case at bar the petitioner's inventories were available at their market value as a means of raising money to pay taxes, but not at any greater amount until after the year 1919. The decision of the Court of Claims is inconsistent also with the decisions of this Court which hold that the Federal income tax system is based on an annual accounting period and that taxes are fixed by what happens in that period. Recent decisions to this effect are Lucas v. Kansas City Structural Steel Co., 281 U. S. 264, and Lucas v. American Code Co., Inc., 280 U. S. 445.

The Court of Claims in relying on Producers' Fuel Co., 1 B. T. A. 202, as involving a principle which applies in the case at bar (Opinion of the Court, record, p. 87) has failed to observe the decision of this Court in Lucas v. American Code Co., Inc., 280 U. S. 445, which shows that the principle of the Producers' Fuel Co. case is narrowly limited and applies only to special facts not found in the case at bar.

[fols. 22 & 23] The decision of the Court of Claims is also inconsistent with good accounting practice, which is recognized both by the Revenue Act of 1918 and by the regulations as a standard which should be observed (Revenue Act of 1918, sec. 203; Regulations 45, art. 1582, as amended by Treasury Decision 3296). The material provisions of the Revenue Act and the Regulations will be found in the brief to be filed in support of this petition. Good accounting practice treats inventories as a part of quick assets and working capital and demands that inventories which are to be valued at cost or market whichever is lower should represent present value and not future expectations.

The decision of the Court of Claims is also inconsistent with the provisions of the regulations with respect to valuation of inventories and also with those relating to proceeds of claims from Government contracts (Regulations 45, art. 1582-1584, as amended by Treasury Decisions 3296; Regulations 62, art. 51; Regulations 65, art. 50). These regulations will be printed and the effect of them will be referred to in more detail in the petitioner's brief.

Wherefore the petitioner respectfully submits that the petition for the writ should be granted.

United States Cartridge Company, by Harry LeBaron Sampson, Counsel for Petitioner.

[fols. a & 1] IN COURT OF CLAIMS OF THE UNITED STATES

No. H-522

UNITED STATES CARTRIDGE COMPANY

v.

UNITED STATES

PETITION—Filed December 5, 1927

To the Honorable the Chief Justice and Judges of the Court of Claims:

Your petitioner says:

1. The petitioner is a corporation duly organized under the laws of the Commonwealth of Massachusetts formerly having its principal place of business at Lowell in said Commonwealth and now having its principal place of business in Boston, Massachusetts, and has at all times borne true allegiance to the Government of the United States and has not in any way aided, abetted, or given encouragement to rebellion against said Government. The petitioner is the owner of the claim hereinafter described and no other person is interested therein and no assignment or transfer of said claim or any part thereof or interest therein has been made.

[fol. 2] 2. The petitioner brings this petition to recover a portion of the income and profits taxes assessed by the Commissioner of Internal Revenue (hereinafter called the Commissioner) upon the petitioner on its income for the year 1918, and paid by the petitioner to the United States through the Collector of Internal Revenue at Boston, Massachusetts. The petitioner alleges that the taxes so assessed and paid are excessive in the respects stated below. The petitioner is justly entitled to the amount herein

or would reimburse the petitioner for the cost of the partly manufactured cartridges or materials intended for the manufacture of the same. The petitioner has never been able to obtain such reimbursement from any source.

10. The name of the Maxim Munitions Corporation was changed on March 4, 1919, to Maxim Corporation. In this petition said corporation is called the Maxim Munitions [fol. 15] Corporation after, as well as before, the change. On June 18, 1919, said corporation was adjudicated a bankrupt in the District Court of the United States for the Southern District of New York. The petitioner on or about July 10, 1919, secured a conveyance from the receiver in bankruptcy of said Maxim Munitions Corporation of the rights of said corporation under its contract with the Purchaser, and of all claims arising under said contract against the Purchaser or the Kingdom of Italy. Said conveyance was conditioned upon the petitioner's making a settlement with Officine di Villar Perosa or the Kingdom of Italy within a reasonable time, and a part of the consideration for such conveyance was the agreement of the petitioner to pay to the estate in bankruptcy of Maxim Munitions Corporation a specified portion of the proceeds of any such settlement. Officine di Villar Perosa had no property in the United States and could not be served with process in the United States. The petitioner attempted by negotiation with the Kingdom of Italy to secure payment for the undelivered completed cartridges and for the materials and work in process hereinabove described. Said negotiations were continued for several years but were without results. By reason of the failure of such negotiations said conveyance was subject to being rescinded by the District Court of the United States for the Southern District of New York. Thereafter on March 16, 1926, the petitioner purchased from the trustee in bankruptcy of said Maxim Munitions Corporation for the sum of $61,250 all the right, title and interest of the bankrupt estate and of said Maxim Munitions Corporation and of its trustee in bankruptcy under the agreement between the Maxim Munitions Corporation and Officine di Villar Perosa, and all rights and causes of action of said bankrupt and said trustee in bankruptcy [fol. 16] and the bankrupt estate against the Kingdom of

Italy and Officine di Villar Perosa and against the sureties on a certain bond which had been given by the Maxim Munitions Corporation to Officine di Villar Perosa in connection with the contract, and all right, title and interest of said bankrupt estate and said trustee in bankruptcy in or to certain collateral security held by said sureties. The material facts relating to said bond and the collateral security therefor are stated in the following paragraph of this petition. The petitioner has never collected anything upon such assignment or received anything thereunder except to such extent, if any, as said assignment may have operated to give title to the petitioner to certain moneys advanced to the petitioner by said sureties as hereinafter more particularly stated.

11. Under the contract between Maxim Munitions Corporation and the Purchaser, the Purchaser had paid to the Maxim Munitions Corporation $1,531,250 which was payment in advance for the last 25% of the cartridges to be delivered under said contract. The Maxim Munitions Corporation as principal and the Maryland Casualty Company, the Fidelity & Deposit Company of Maryland, and the United States Fidelity & Guaranty Company, all of Maryland, as sureties, had executed a bond in the penal sum of $1,531,250 to the Purchaser dated March 22, 1917, the condition of which was:

"Now, therefore, the condition of this obligation is such that in case of default by the Principal in the delivery of any of the cartridges as provided for in said contract, and in case of the cancellation of said contract, or in either or both of these events, the Principal shall well, truly and promptly pay or cause to be paid to the Obligee, all of its deposit as aforesaid, after deducting any payments made [fol. 17] on account of the last twenty-five per cent (25%) of the cartridges to be delivered under the terms of said contract, then this obligation shall be void, otherwise to remain in full force and effect; provided, however, and upon the express condition which shall be precedent to the right of recovery hereunder as follows:

(1) That the Obligee shall do and perform each and every act upon its part to be kept and performed and shall make the payments at the time and in the manner in said

contract contained, according to the terms and conditions thereof.

(2) That in the event of a default occurring as to deliveries or in the event of a cancellation of said contract, notice of same shall be given in writing by the obligee or his representatives to the Sureties, within thirty (30) days after the same shall have occurred, and the said notice shall be addressed to the Home Office of the several sureties."

By the terms of said bond the liability of the Maryland Casualty Company was limited to $765,625, and the liability of each of the other two sureties was limited to $382,812.50. Said Maxim Munitions Corporation, at or about the date of the execution of said bond, deposited with each of said sureties cash to the full amount of the liability of said surety under said bond, and entered into an agreement with each of said sureties, giving to each of them the right to retain said cash as collateral until its liability on account of having signed said bond should cease. Each of said agreements also provided that in case the surety should, because of having executed said bond, sustain or incur any liability or be put to any loss or counsel fees or expenses of whatever kind or nature, the surety should have full power to appropriate the proceeds of such collateral in order to pro- [fol. 18] tect itself, and that the surety should also have the right to deduct from said collateral all premiums due it on account of executing such bond. Said agreements with the Maryland Casualty Company and the Fidelity & Deposit Company of Maryland also provided for similar rights in case the respective sureties were threatened with any liability in consequence of having executed said bond. Each agreement also provided that on the termination of the liability of the surety on said bond without loss or damage, and competent evidence furnished to the surety to that effect, said collateral should be returned to the Maxim Munitions Corporation upon the surrender of said agreement properly endorsed. Said agreements have never been so surrendered. By agreements between said Maxim Munitions Corporation and said sureties and the Purchaser, the penal sum of said bond and the collateral held by each surety and the liability of each surety under said bond was reduced by one-half, and one-half of the collateral held by each surety was refunded to the Purchaser.

12. On or about October 20, 1917, the petitioner, with the assent of the Maxim Munitions Corporation, borrowed from said sureties $612,500 of the collateral deposited with them as aforesaid, of which amount $306,250 was borrowed from the Maryland Casualty Company and $153,125 from each of the other sureties. Said amounts were borrowed under agreements dated on or about October 20, 1917. For such loans the petitioner gave notes to the respective sureties which were guaranteed by the National Lead Company, a corporation organized under the laws of the State of New Jersey. A copy of the agreement between the petitioner and the Fidelity & Deposit Company of Maryland is hereto annexed marked Exhibit C and made a part hereof, [fol. 19] and a copy of the note given to said surety and of the guaranty by the National Lead Company is hereto annexed marked Exhibit D and made a part hereof. Agreements and notes in similar form were given by the petitioner to the other sureties for amounts corresponding to the advances made by the respective sureties. Each of said agreements provided that the surety to which it ran would hold such note in lieu of money released to the petitioner; that when the contract between the Maxim Munitions Corporation and the Purchaser had been duly completed and proof satisfactory to the surety had been furnished the note should be returned to the petitioner; and that in the event of a default in the performance of the contract between the Maxim Munitions Corporation and the Purchaser and any modification thereof accepted by the Purchaser, the surety might at its option immediately reduce the note to cash and should hold for its protection the money thus received as fully and completely as though all the money derived from said note had been originally deposited with it under the collateral agreement between the surety and the Maxim Munitions Corporation. After the reduction of the collateral held by the sureties by one-half, as stated above, and after the advances made by said sureties to the petitioner out of said collateral, said sureties held the notes of the petitioner and cash collateral to the amount of $153,125, of which one-half was held by the Maryland Casualty Company and one-fourth by each of the other sureties.

13. On October 19, 1923, each of the said sureties brought a suit in equity against the petitioner to recover the amount

of said notes. Said suits were brought in the Superior Court for the County of Suffolk and Commonwealth of [fol. 20] Massachusetts and were pending at the date of the assessment of additional taxes upon the petitioner for the year 1918 made as stated in Paragraph 5 of this petition; and said suits are now pending. The sureties still hold the cash amounting to $153,125 and the petitioner's notes referred to in the preceding paragraph, and the petitioner has received nothing under the above described purchase from the trustee in bankruptcy of the Maxim Munitions Corporation.

14. On December 31, 1918, when the inventory of the petitioner at the end of the year 1918 was taken, there was no market for said nine-millimeter cartridges or for said work in process intended for use in said cartridges, except as scrap, and no market for unmanufactured materials intended for such use except as scrap or as raw materials; and the market value of all of such articles was much less than the cost of the same. The market value at the aforesaid time of such completed cartridges, work in process and materials on hand owned by the petitioner was $79,297.11. The Commissioner, in determining the petitioner's tax for the year 1918 as aforesaid, valued such cartridges, work in process and materials at the end of the year 1918 at $274,659.78, thereby increasing the apparent income of the petitioner on which the Commissioner computed the petitioner's taxes by the difference between said market value of the articles and the value assigned to the same by the Commissioner, which difference amounts to $195,362.67.

15. Another difference arose between the petitioner and the Commissioner as to the value of a large quantity of materials and work in process owned by the petitioner at the end of the year 1918, which were intended for use under contracts between the petitioner and the United States. [fol. 21] These contracts provided for the manufacture and delivery by the petitioner to the United States of .45 caliber cartridges and artillery primers at prices fixed in the contracts. These contracts had all been made on behalf of the United States by representatives of the Chief of Ordnance acting under the authority of the Secretary of War. Before the end of the year 1918 it appeared to the Chief of Ordnance that on account of the suspension of hostilities

following the Armistice, the United States would have no need for the greater part of these completed articles. Accordingly the Chief of Ordnance caused the petitioner to be notified in writing to suspend further operations under said contracts, except such as were necessary to complete limited quantities of articles specified in some of such notices which were much less than the total called for by the contracts. Each notice also stated that this request to suspend operations was made with a view to the negotiation of a supplemental contract providing for the cancellation, settlement and adjustment of the existing contract with the petitioner to which such notice referred. The contracts between the petitioner and the United States which were affected by these notices were as follows:

(a) A contract known in the Ordnance Department as P6489-1489Sa providing for the delivery of 60,100,000 .45 caliber cartridges and a supplement thereto providing for the delivery of 75,000,000 of such cartridges in addition to those provided for by the original contract.

(b) A contract known in the Ordnance Department as P12289-3034A providing for the delivery of 9,000,000 49-grain artillery primers.

(c) A contract known in the Ordnance Department as GA-126 providing for the delivery of 5,000,000 110-grain artillery primers.

[fol. 22] (d) A contract known in the Ordnance Department as P12621-3124A providing for the delivery of 1,000,000 110-grain artillery primer bodies.

In December, 1918, the petitioner received notices requesting suspension of production under all these contracts. Copies of said notices are hereto annexed marked Exhibits E, F, G and H and made a part hereof. The petitioner complied with the requests contained in these notices.

16. Negotiations for the settlement of the claims of the petitioner arising out of the suspension of production under said contracts took place between the petitioner and representatives of the Chief of Ordnance, but were not completed until after the year 1919. The material and work in process intended for use under said contracts were

in the possession of the petitioner until the spring of 1920, at which time the United States, acting through the Secretary of War and persons authorized by him, agreed to take possession of the greater part of this material and work in process and to reimburse the petitioner for it at cost. The War Department declined, however, on one ground or another, to take over a certain quantity of material included in the petitioner's inventory which the petitioner claimed was intended for use under such contracts. Until such agreements were reached in 1920, the petitioner had no enforcible rights by which it could require the United States to take over this material and to pay cost for it, as the petitioner's contract called for the delivery of completed articles and not for raw material or work in process, except in an event which has not happened, namely, the termination of such contracts in accordance with certain provisions therein contained and after notice provided for in [fol. 23] such contracts. There was no reasonable probability at the end of December, 1918, that the United States would accept and pay for the completed articles specified in the contracts. It was not known until after December 31, 1919, whether the petitioner would eventually receive its compensation on account of the suspension of work under said contracts in part by being paid for such materials and work in process at cost and delivering the same to the United States, or whether the petitioner would have to sell the same for what they would bring, and to prosecute its claims against the United States for any damages which the petitioner might have suffered. There was no market on December 31, 1918, for completed articles of the kind specified in these contracts, and it was therefore not possible for the petitioner to use said materials and work in process advantageously by manufacturing the same into the articles for which they had been intended. Unless the negotiations with the United States should result in such materials and work in process being taken over at cost, the petitioner would be unable to realize more than the going market value for this property. The market value for much of said property on December 31, 1918, was only its value as scrap. With respect also to the supplement to contract P6489-1489Sa, there was the further difficulty that said supplement had not been executed in the manner required by law and was not enforcible against the United States.

This defect was subsequently cured under the provisions of the Act of March 2, 1919, known as the Dent Act; but on December 31, 1918, the petitioner had no enforcible claim against the United States on account of that portion of the material and work in process in its possession which was intended for use under said supplement to contract P6489-1489Sa.

[fol. 24] 17. The petitioner at the time of the determination by the Commissioner of the taxable income of the petitioner for the year 1918, claimed the right to have said material and work in process intended for use under contracts with the United States valued at the end of 1918 at its market value, which was lower than cost. It is contrary to good accounting practice to value goods at prices in excess of their value as merchandise in cases in which production has been suspended under contracts and the possibility of realizing payment for the goods at cost depends entirely on future negotiations. The Commissioner, however, in determining the income of the taxpayer for said year, valued at market value at said date only that portion of such material and work in process which the United States eventually in the year 1920 declined to accept and to pay for at cost; and valued at cost to the petitioner of all of such material and work in process which was taken over and paid for by the United States at cost as a part of the above described settlements made in the year 1920. The correct valuation of such material and work in process on December 31, 1918, if taken at cost or market value, whichever was lower, was $231,615.43. The Commissioner, in determining the income of the taxpayer for such year, valued such material and work in process at the end of the year 1918 at $732,088.62, thereby increasing the apparent income of the petitioner for the year 1918 by $500,473.19.

18. The Commissioner, in determining the income of the petitioner for the year 1918 disallowed a deduction claimed by the petitioner for that year amounting to $327,937.35. The petitioner was and is entitled to this deduction by reason of a loss sustained by the petitioner in its business dur-[fol. 25] ing the year 1918 in the value of the petitioner's interest in certain buildings erected by the petitioner on leased lands for use by the petitioner in the manufacture

of munitions for war purposes, which buildings in the year 1918 became no longer useful for such purposes on account of the termination of hostilities and the consequent cessation of the demands for munitions. The facts concerning this claim are stated below in Paragraphs 19 to 23 of this petition. The petitioner's right to deduct such loss from its gross income for the year 1918 in the determination of its taxes for said year arises under the Revenue Act of 1918 and particularly under Sections 232 and 234a. The taxpayer also alleges that such deduction is in accordance with Articles 561 and 143 of Regulations 45 promulgated by the Commissioner of Internal Revenue and approved by the Secretary of the Treasury on December 29, 1919. Said articles are as follows:

"Art. 561. Allowable Deductions.—In general the deductions from gross income allowed corporations are the same as allowed individuals, except that corporations may deduct dividends received from other corporations subject to the tax and may not deduct charitable contributions, and that insurance companies are permitted special deductions. See section 214 of the statute. Particularly as to business expenses see articles 101-111; as to interest paid see articles 121 and 122; as to taxes paid see articles 131-134; as to losses see articles 141-145; as to bad debts see articles 151-154; as to depreciation see articles 161-171; as to amortization see articles 181-188; as to depletion see articles 201-233; and as to loss in inventory see articles 261-268."

"Art. 143. Loss of Useful Value.—When through some change in business conditions the usefulness in the business [fol. 26] of some or all of the capital assets is suddenly terminated, so that the taxpayer discontinues the business or discards such assets permanently from use in the business, he may claim as a loss for the year in which he takes such action the difference between the cost or the fair market value as of March 1, 1913, of any asset so discarded (less any depreciation allowances) and its salvage value remaining. This exception to the rule requiring a sale or other disposition of property in order to establish a loss requires proof of some unforeseen cause by reason of which the property must be prematurely discarded, as, for example, where machinery or other property must be replaced by a new invention, or where an increase in the cost

of or other change in the manufacture of any product makes it necessary to abandon such manufacture, to which special machinery is exclusively devoted, or where new legislation directly or indirectly makes the continued profitable use of the property impossible. This exception does not extend to a case where the useful life of property terminates solely as a result of those gradual processes for which depreciation allowances are authorized. It does not apply to inventories or to other than capital assets. The exception applies to buildings only when they are permanently abandoned or permanently devoted to a radically different use, and to machinery only when its use as such is permanently abandoned. Any loss to be deductible under this exception must be charged off on the books and fully explained in returns of income. But see articles 181-188."

19. For many years prior to the beginning of the World War in 1914, the petitioner had been engaged in the manufacture of ammunition for small arms, which was used principally for sporting purposes. This business was highly competitive and the market for the product was so limited that there was no prospect of any large increase in [fol. 27] the business. In the year 1913 the petitioner employed, on the average, about 350 persons. Said business was carried on principally at Lowell, Massachusetts, in buildings which were leased from the Wamesit Power Company. The principal plant so leased was situated on Lawrence Street, Lowell, and land was also leased in a part of said Lowell known as South Lowell.

20. In the latter part of 1914 representatives of European governments which were then at war placed large contracts with the petitioner for ammunition for war use. The performance of these contracts required more buildings than the petitioner had under lease. The petitioner's landlord, the Wamesit Power Company, was unwilling to construct buildings for use by the petitioner for the manufacture of munitions for war purposes, as such use would be of limited duration and it did not appear that after such use had ceased the buildings could be rented at a price which would yield a reasonable return upon their cost. The petitioner for the purpose of filling war orders which

it had received and further orders which it expected to obtain while the war continued, constructed buildings upon the land belonging to said Wamesit Power Company under an agreement in terms as follows:

"Whereas, the United States Cartridge Company wishes to increase the size of some of the buildings now rented from the Wamesit Power Company and to erect new buildings and make other improvements on the property of the Wamesit Power Company, and the Wamesit Power Company does not wish to make the necessary investment therefor, it is therefore agreed that the United States Cartridge [fol. 28] Company may erect and occupy such buildings for ten years from January first nineteen hundred and fifteen, paying no rent therefor to the Wamesit Power Company for said ten years and at the end of said ten years, the buildings and improvements shall become the property of the Wamesit Power Company and shall thereafter be subject to rental by the Wamesit Power Company.

"If the United States Cartridge Company shall desire to vacate said buildings or any part of them before the end of the term of ten years, the Wamesit Power Company shall give the United States Cartridge Company all possible assistance in renting said buildings for the remainder of the term of ten years, the rental to be paid to and be for the benefit of the United States Cartridge Company.

"The United States Cartridge Company shall pay the taxes on the buildings, shall keep the buildings fully insured and in case of loss, the United States Cartridge Company shall replace the buildings in as good condition as before, or if the United States Cartridge Company shall not desire to rebuild, the Wamesit Power Company shall have the option of taking the amount received from insurance and rebuilding or not."

Said agreement was approved by vote of the directors of the Wamesit Power Company on May 8, 1915, but had been entered into before said date.

21. The petitioner from time to time received further orders for munitions for war use and found it necessary still further to enlarge the buildings upon the leased property. The petitioner accordingly erected from time to time in the years 1914 to 1917 various buildings on the land of

the Wamesit Power Company for the purpose of providing facilities to fill its war orders, all of which were erected [fol. 29] subject to the agreement stated above. The amount expended by the petitioner in the erection of the said buildings in each of said years was

1914	$5,725.25
1915	634,967.55
1916	160,839.84
1917	966.85
	$802,499.49

Of this amount $436,930.63 was spent in the erection of buildings on land of the Wamesit Power Company on Lawrence Street, Lowell, and $365,568.86 was spent in the erection of buildings on land of the Wamesit Power Company at South Lowell. In order to fill its orders for war business received from European governments, and also from the United States, after the United States entered the war in April, 1917, the petitioner's business was enormously increased. At the peak of the petitioner's war time activities the number of its employees had increased to about 15,000 and the space occupied by the petitioner was many times that which was necessary for its pre-war business or for any business which the petitioner might expect to do after the war. The petitioner made charges to depreciation on account of the cost of the buildings erected by it so calculated as to extinguish such cost at the expiration of the lease by equal annual instalments. Until the time of the Armistice, November 11, 1918, there was a demand for war purposes for all of the munitions which the petitioner could manufacture in said buildings, and the petitioner was unable, until that date, to determine when such use of said buildings would be discontinued, and consequently could not charge off any loss on account of the cost of said buildings in computing its income and [fol. 30] excess profits taxes other than the proportionate yearly depreciation based on the length of the petitioner's lease which has been described. Before the end of the year 1918, however, the petitioner's officers knew that the demand for munitions for war purposes had ceased.

22. On December 31, 1918, the value of the use of the buildings for the remainder of the lease based on the usual

rate of rent prevailing in Lowell for such buildings (hereafter called the residual value of the buildings) was $190,969.86. The petitioner claimed as a loss in the year 1918 in computing its income, excess profits and war profits taxes the difference between said residual value and the cost of said buildings, less said depreciation to December 31, 1917. The loss so claimed amounted to $414,421.89, computed as follows:

Original cost of buildings	$802,499.49
Depreciation to December 31, 1918	197,107.74
Depreciated value December 31, 1917	605,391.75
Residual value December 31, 1918	190,969.86
Loss for the year 1918	$414,421.89

Of this amount the Commissioner, in determining the petitioner's taxes for the year 1918, allowed depreciation for said year on said buildings amounting to $86,484.54 and refused to allow the remainder of the amount of said loss, which was $327,937.35. The Commissioner, in declining to allow the remainder of the petitioner's loss, ruled that said buildings had not been wholly abandoned by the petitioner and that no deduction for loss was allowable under Articles 561 and 143 of Regulations 45, which have been quoted in [fol. 31] Paragraph 18 of this petition. The use made by the petitioner of said buildings, upon which the Commissioner relied in this ruling, is stated below.

23. The petitioner, having in effect paid the rent in advance for the entire period of the lease, attempted to make some use of these buildings after the war and for that purpose engaged to a limited extent in the manufacture of other articles than munitions. Such attempts were not successful, however. The volume of this business was very small as compared with the volume of the war business of the petitioner. The number of the petitioner's employees engaged in this business was less than 10 per cent of the maximum number employed by the petitioner in its war business. The Commissioner found that the percentage of the floor space of the buildings erected by the petitioner for its war business which was occupied by the petitioner's peace-time business after the war, was 40 per cent of the

floor space of such buildings in the petitioner's plant at Lawrence Street, Lowell, and 28 per cent of the floor space of such buildings at South Lowell. The petitioner says that the portion of the floor space in said buildings needed by the petitioner for the conduct of its normal business after the war was no more than the portion found by the Commissioner. Notwithstanding the fact that the petitioner had no occasion to use said buildings except to the extent which has been stated, the Commissioner ruled that no deduction was allowable for the year 1918 on account of the loss of useful value of such buildings or of the petitioner's leasehold, except the depreciation which has been stated. The petitioner says that the Commissioner erred in said ruling and that such deduction was properly allowable under said Regulations 45 and the portion thereof above referred to, [fol. 32] and further says that the war time purposes for which said buildings were used were in fact radically different uses from the uses which were made of such buildings by the petitioner for its business after the war. The petitioner further says that if said Regulations are to be interpreted as denying to the petitioner any deduction from its gross income on account of the loss suffered by it as aforesaid, said Regulations are in violation of the provisions of the Revenue Act of 1918 and to that extent are void; and the petitioner is entitled to such deduction under the provisions of said Revenue Act and particularly under Section 234a thereof.

24. The correct net income of the petitioner for the year 1918, after making the deductions to which the petitioner was entitled, including the deduction for loss of useful value of the petitioner's leasehold described in Paragraphs 18 to 23 of this petition, was $768,659.37. The invested capital of the petitioner for the year 1918, determined in accordance with the Revenue Act of 1918 was $4,580,808.44. The petitioner was entitled to a war profits credit for said year of $461,080.84 and to an excess profits credit of $369,464.68. The total amount of income, war profits and excess profits taxes properly to be assessed upon the petitioner for said year 1918 was $308,534.41. A schedule showing the computation of these taxes is hereto annexed marked Exhibit I. The Commissioner by valuing the above described manufactured and partly manufactured nine-millimeter car-

tridges and the work in process and materials for such cartridges and the work in process and materials intended for use under the petitioner's contracts with the United States at the amounts hereinabove stated in this petition, instead of at cost or market value whichever was lower, in-
[fol. 33] creased the gross income of the petitioner on which the Commissioner computed the petitioner's tax for said year by the amounts of $195,362.67 and $500,473.19, making a total increase in such gross income of $695,835.86. The Commissioner by such increase in the valuation of the above described articles and by disallowing the deduction of $327,-937.35 described in Paragraphs 18 to 23 of this petition increased the net income of the petitioner on which the Commissioner based said taxes from $768,659.37, which was the correct net income of the petitioner for said year, to $1,792,432.58. In consequence thereof the Commissioner assessed upon the petitioner the additional tax of $642,-914.24 described in Paragraph 5 of this petition, which was in addition to the original assessment of $509,209.29, making a total tax of $1,152,123.53 which has been assessed on the petitioner for said year and has been paid by the petitioner as stated above. The petitioner is entitled to recover the difference between said amount and $308,534.41, the correct tax for said year, or $843,589.12, with interest thereon from the date of payment to the date of the judgment in this suit as provided by Section 1117 of the Revenue Act of 1926. Such interest should be computed at 6 per cent from June 14, 1919, the date when the payment of the original assessment of $509,209.29 was completed, on $200,674.88, the difference between said original assessment and the correct tax of $308,534.41. Such interest should also be computed on the additional tax of $642,914.24 from March 31, 1926, the date of payment of said tax.

25. The material facts relating to the overpayments of the petitioner's taxes for the years 1917 and 1919 which were applied by the Commissioner in part payment of the above described additional assessment of taxes for the year 1918 are stated below. Prior to June 24, 1918, the Com-
[fol. 34] missioner assessed upon the petitioner income and profits taxes for the year 1917 amounting to $126,102.87. The petitioner on June 24, 1918, paid said amount to the Collector of Internal Revenue at Boston, Massachusetts.

The correct amount of such taxes which should have been assessed upon the petitioner for said year was $122,955.86. The Commisisoner in or about the month of January, 1926, having determined that the correct amount of such tax was $122,955.86, issued a certificate of overassessment and directed that the overpayment of taxes for said year 1917 amounting to $3,147.01 should be applied upon the additional taxes assessed for the year 1918 and said amount was so applied as stated in Paragraph 5 above. The Commissioner at some time prior to December 15, 1920, assessed upon the petitioner income and excess profits taxes for the year 1919, amounting to $472,372.50. $445,508.39 was paid by the petitioner upon said assessment, of which amount $390,790.71 was paid by the application to said assessment for 1919 of the overpayment of taxes then assessed for 1918 as stated in Paragraph 3 of this petition and $54,717.68 was paid in cash by the petitioner to the Collector of Internal Revenue at Boston on December 15, 1920. All of said payments were made long prior to the year 1926. The correct amount of taxes which should have been assessed upon the petitioner for said year 1919 was $35,331.88. The difference between this amount and the amount which had been paid by the petitioner upon said tax was $410,176.51. The Commissioner in January, 1926, having determined that the correct tax of the petitioner for 1919 was $35,331.88, issued a certificate of overassessment directing that $409,416.89 of the overpayment made by the petitioner should be applied upon said additional assessment for the [fol. 35] year 1918, and said amount was so applied. The balance of said overpayment was applied upon additional assessments for 1915 and 1916 which are not material.

26. The petitioner on or about February 29, 1924, duly filed its claim for refund of taxes paid for said year 1918. In said claim for refund the petitioner claimed to be entitled to be repaid $451,839.51 of the taxes, amounting to $509,209.29, for the year 1918 which had then been assessed upon the petitioner for the year 1918. Said claim for refund included all the items upon which this petition is based. At the time said claim was filed the Revenue Act of 1921 was in force. Under the provisions of this Act, and particularly Section 252 thereof, the petitioner was entitled to have refunded any amount of its income, war profits or excess

profits taxes for the year 1918 which was in excess of the proper amount of such taxes, provided that claim for refund of the same should be filed by the petitioner within five years from March 15, 1919, the date when the petitioner's return for the year 1918 was due. As the petitioner's claim had been filed within the period prescribed by said Act, the petitioner's rights to recover said refund were preserved under the provisions of Section 281(f) of the Revenue Act of 1924 (which was enacted June 2, 1924) and of Section 284(h) of the Revenue Act of 1926 (which was enacted February 26, 1926), both of which sections provided that the provisions of the respective sections should not bar from allowance a claim for refund filed prior to the enactment of said respective Acts. The petitioner on or before June 15, 1924, had filed with the Commissioner a waiver of its right to have the tax due for the taxable year 1918 determined and assessed within five years after its return [fol. 36] for said year was filed, and the petitioner was and is also entitled under Section 281 of the Revenue Act of 1924 and under Section 284 of the Revenue Act of 1926 to a refund of any overpayment of tax for said year, having filed a claim therefor on February 29, 1924, as aforesaid. Said claim for refund was disallowed by the Commissioner on January 20, 1926. After payment by the petitioner of said additional tax of $642,914.24 on March 31, 1926, the petitioner on January 24, 1927, filed an amended claim for the refund of said taxes for the year 1918 claiming a refund of the same amount claimed in this petition, namely $843,589.12 and on account of the same items. Said claim for refund was disallowed by the Commissioner on April 11, 1927. The petitioner is entitled to said refund under the provisions of the Revenue Act of 1926, and particularly Sections 284(a) and 284(g) thereof.

27. No action has been taken upon your petitioner's claim in Congress or by any of the departments except the Treasury Department, and the claims presented by this petition are not the subject of any suit before any other court or of any petition to the Board of Tax Appeals. This petition fully sets forth all action in the Treasury Department upon such claims which is known to your petitioner, and the petitioner believes the facts as stated in this petition to be true.

28. Your petitioner prays,

1. That the Court will render judgment against the United States in favor of your petitioner for payment by the United States to your petitioner of the sum of $843,589.12, with interest at the rate of six per centum per annum on $200,674.88 of said amount from June 14, 1919, and [fol. 37] on $642,914.24 of said amount from March 31, 1926, to the date of judgment.

2. That the Court will render such other and further judgment against the United States in favor of your petitioner as may be due on the facts as they may appear in this case.

United States Cartridge Company, by W. R. B. Whittier, Treasurer. Harry Le Baron Sampson, Attorney of Record.

Duly sworn to by W. R. B. Whittier. Jurat omitted in printing.

[fol. 38] EXHIBIT A TO PETITION

Form NP-2

Treasury Department, Washington

Office of Commissioner of Internal Revenue

Address reply to Commissioner of Internal Revenue and refer to IT:CR:E-60D. ES.

December 4, 1925.

United States Cartridge Company, Lawrence Street, Lowell, Massachusetts.

SIRS: An examination of your income tax returns and of your books of account and records discloses an additional tax liability for the years 1915, 1916 and 1918 aggregating $643,673.86, and overassessments for the years 1917 and 1919 amounting to $440,187.63 as shown in the attached statement and accompanying schedules.

In accordance with the provisions of Section 274 of the Revenue Act of 1924, you are allowed 60 days from the date of mailing of this letter within which to file an appeal to

the United States Board of Tax Appeals contesting in whole or in part the correctness of this determination.

Where a taxpayer has been given an opportunity to appeal to the United States Board of Tax Appeals and has not done so within the 60 days prescribed and an assessment has been made, or where a taxpayer has appealed and an assessment in accordance with the final decision on such appeal has been made, no claim in abatement in respect of any part of the deficiency will be entertained.

If you acquiesce in this determination and do not desire to file an appeal, you are requested to sign the inclosed [fol. 39] agreement consenting to the assessment of the deficiency and forward it to the Commissioner of Internal Revenue, Washington, D. C., for the attention of IT:CR:E-60D:ES. In the event that you acquiesce in a part of the determination, the agreement should be executed with respect to the items agreed to.

Respectfully, D. H. Blair, Commissioner, (s) by C. R. Nash, Assistant to the Commissioner.

Inclosures: Statements, Agreement—Form A—Schedules 1 to 25, incl.

Form 7861—Aug. 1924. 2-13281, Government Printing Office.

IT:CR:E-60D. ES.

Statement of Returns Examined and Resulting Tax Liability

Returns Examined

Company	Year	Forms
United States Cartridge Co., Lowell, Massachusetts	1915	1031 Original
		1031 Amended
	1916	1031 Original
		1031 Amended
	1917	1031–1103
	1918	1120
	1919	1120 Consolidated
Wamesit Garage Company, Lowell, Massachusetts	1917	1031–1103
	1918	1120

[fol. 40]

Tax Liability

Name of company	Year	Additional taxes	Over-assessments
U. S. Cartridge Company, Lowell, Massachusetts	1915	$241.34	
	1916	518.28	
	1917	.....	$3,147.01
	1918	642,914.24	
	1919	.....	437,040.62
Totals		643,673.86	440,187.63
Wamesit Garage Company, Lowell, Massachusetts	1917	241.22	
	1918	No change	
Total		241.22	

IT:CR:E-60D. ES

Statement Continued

In re UNITED STATES CARTRIDGE Co., Lowell, Massachusetts

Revenue Agent's Report dated January 24, 1923 and the report of the Auditor from Travel Unit, Consolidated Returns Audit Division, dated October 10, 1923, together with the information submitted at the conference of June 23, 1924 have been made the basis of adjustments which are fully explained in the attached schedules 1 to 25 inclusive.

Certificates of Overassessment for the amounts shown above will be issued through the office of the Collector of Internal Revenue for your district, and will be applied by that official in accordance with the provisions of Section 281 (a) of the Revenue Act of 1924.

It is noted that waivers, expiring December 31, 1925, have been filed covering the years 1915, 1916, 1917, 1918 and 1919.

The right of appeal as set forth herein applies only to those years in which there is a deficiency in tax as defined by Section 273 of the Revenue Act of 1924.

This letter supersedes office letter dated March 18, 1924.

[fol. 41] United States Cartridge Company, Year Ended December 31, 1918

Schedule 15

Consolidated Net Income

Net income as shown in office letter dated March 18, 1924	$3,229,729.86
As corrected	1,792,432.58
Deduction	1,437,297.28
Deduction:	
(a) Income from Government claims	1,437,297.28

Schedule 16

Explanation of Items Changed

(a) The 1918 income shown in office letter dated March 18, 1924, included $1,437,297.28 received on Government claims subsequent to 1918. The decision made at the Conference of June 23, 1924, held this amount to be income for the year in which it was received.

Schedule 17

Consolidated Invested Capital, 1918

As shown in office letter dated March 18, 1924		$4,646,951.21
As corrected		4,580,808.44
Net decrease as explained below		66,142.77
Increases:		
(a) 1917 income and profits taxes		14,132.46
Decreases:		
(b) 1915 and 1916 additional income taxes	$759.62	
(c) 1917 income from Government claims	75,936.45	
(d) Additional depreciation for 1917	3,579.16	
Total decrease		80,275.23
Net decrease as above		$66,142.77

[fol. 42] United States Cartridge Company, Year Ended December 31, 1918

Schedule 18

Explanation of Items Changed

(a) Corrected 1917 income and profits taxes, $123,197.08, prorated 200 days	$67,505.25
Amount deducted from invested capital in office letter dated April 18, 1924	81,637.71
Difference to be restored to invested capital	$14,132.46

(b) For explanation of this adjustment see Schedule 10.

(c) Invested capital is reduced by the $75,936.45 decrease in 1917 income for government claims. See Item (a), Schedule 7.

(d) This adjustment is for the $3,579.16 additional depreciation allowed for 1917. See Item (b) Schedule 7.

Schedule 19

Proof of Invested Capital

Capital Stock		$800,000.00
Surplus		3,849,073.31
Total, corrected balance sheet beginning of year		4,649,073.31
Reductions:		
1915 and 1916 additional taxes	$759.62	
1917 taxes prorated	67,505.25	
Total (deduct from above)		68,264.87
As shown on Schedule No. 17		$4,580,808.44

[fol. 43] United States Cartridge Company, Year Ended December 31, 1918

Schedule 20

Computation of Excess Profits and War Profits Credits

Consolidated net income taxable year (Schedule 15)	$1,792,432.58
Consolidated invested capital taxable year (sch. 17)	4,580,808.44
Excess Profits Credit	
8% of invested capital for taxable year	$366,464.68
Exemption	3,000.00
Excess profits credit	369,464.68
War Profits Credit	
10% of invested capital for taxable year	$458,080.84
Exemption	3,000.00
War profits credit	461,080.84

Schedule 21

Computation of Total Tax, 1918

Excess profits tax	Income	Tax
Net income for taxable year	$1,792,432.58	
Less excess profits credit	369,464.68	
Balance	1,422,967.90	
Taxable at 30%	546,697.01	$164,009.10
Taxable at 65%	876,270.89	569,576.08
	1,422,967.90	733,585.18

War profits tax	Income	Tax
Net income for taxable year	$1,792,432.58	
Less war profits credit	461,080.84	
Taxable at 80%	1,331,351.74	$1,065,081.39
Less excess profits tax		733,585.18
War profits tax		331,496.21
Total excess profits and war profits tax		$1,065,081.39

[fol. 44] United States Cartridge Company, Year Ended December 31, 1918

Schedule 21 (Continued)

Income Tax

Net income for taxable year		1,792,432.58	
Less:			
War profits and excess profits tax	$1,065,081.39		
Exemption	2,000.00		
		1,067,081.39	
Taxable at 12%		725,351.19	87,042.14
Total tax			1,152,123.53
Previously assessed			509,209.29
Additional tax to be assessed			642,914.24

[fol. 45] Exhibit B to Petition

Form 17A. U. S. Internal Revenue. Revised January, 1924. 2-9487

Notice and Demand for Income Tax

Tax	Amount paid	Balance payable	Remarks
$642,914.24	Cr. $409,416.89		1918 Addl. Income RAR Waiver.
	Cr. 3,147.01	$230,350.34	Jan. 1926 Addl. Spl. 7.
			P O L 6 C.
			OL 12-4-25.

Notice is hereby given that there has been assessed against you the amount of tax stated above. Demand is hereby made for the immediate payment of said tax. If payment is not made within ten days after date of this notice, the Act provides that [a penalty of 5 per cent] of the amount of tax due will be added, [plus]* interest at the rate of 1 per cent per month until paid.

Date Mar. 24, 1926.

United States Cartridge Co., Lawrence St., Lowell, Mass.

Jan. 1926. Addl. Spl. 7.

Spl. 7 0-6 C.

*[*Words and figures enclosed in brackets stricken in copy.]

To avoid penalty and interest this tax must be paid within 10 days from the above date to the Collector of Internal Revenue at Boston, Mass.

Date: —— —, ——.

To the Collector of Internal Revenue:

I enclose herewith the sum of $— in payment of the tax shown above.

Name: —— ——, Address: ——.

Return this form with remittance.

———

[fol. 46] EXHIBIT C TO PETITION

This Agreement, made this 20th day of October, 1917, by and between the United States Cartridge Company, party of the first part, and Fidelity and Deposit Company of Maryland, party of the second art, Witnesseth:

Whereas, on or about the 22nd day of March, 1917, the party of the second part became one of several cosureties upon a certain bond of One Million Five Hundred Thirty One Thousand Two Hundred Fifty Dollars ($1,531,250.00) in which Officine di Villar Perosa is obligee and Maxim Munitions Corporation is principal, which said bond was executed in accordance with the provisions of a certain contract between said Maxim Munitions Corporation and said Officine di Villar Perosa; and

Whereas, said Maxim Munitions Corporation did deposit as collateral security with all of said sureties, including the party of the second part, the sum of One Million Five Hundred Thirty One Thousand Two Hundred Fifty Dollars $1,531,250.00) to indemnify said sureties against loss by reason of their having executed said bond, which said sum of money has been distributed among the various sureties in the proportion of their several liabilities under the bond and the portion now held by the party of the second part is subject to the terms of a certain collateral agreement dated the 3rd day of April, 1917, a copy of which is or may be attached hereto and read as a part hereof; and,

Whereas, Maxim Munitions Corporation did, on or about the fifth day of October, 1917, enter into a sub-contract with the United States Cartridge Company for the manufacture of certain cartridges called for by the terms of the first-mentioned contract, by which said sub-contract the Maxim Munitions Corporation did assign to United States Cart-[fol. 47] ridge Company all of said collateral of One Million Five Hundred Thirty One Thousand Two Hundred Fifty Dollars ($1,531,250.00) when and as the same might be released by said sureties under the terms of the several collateral agreements; and,

Whereas, the United States Cartridge Company desires to withdraw from the party of the second part the sum of One Hundred Fifty-three Thousand One Hundred Twenty-Five Dollars ($153,125.00) from the collateral so deposited with it and substitute therefor, upon the same terms and conditions as are set out in the original collateral agreement herein referred to, and except as herein modified, a demand note for the same amount executed by the party of the first part and guaranteed by the National Lead Company, to all of which the party of the second part is willing to consent upon the conditions hereinafter set out.

Now, Therefore, in Consideration of the Premises, and of the mutual covenants herein contained, the parties hereto do agree as follows:

1. That the party of the first part shall execute its ten (10) days demand note, payable to the order of the party of the second part, in the sum of One Hundred Fifty-three Thousand One Hundred Twenty-five Dollars ($153,125.00), and shall, after the same has been validly guaranteed by the National Lead Company, receive in return therefor, from the party of the second part, out of the collateral deposited with said party of the second part an equal amount in cash, check or draft.

2. That the party of the second part will hold said guaranteed note in lieu of the sum of money thus released, and subject in all respects to the terms of the collateral agreement of April 3rd, 1917, except as herein set out, and the said party of the second part will not attempt to collect the said note except in accordance with the terms of this agreement.

[fol. 48] 3. That if and when the aforesaid contract between Maxim Munitions Corporation and Officine di Villar Perosa, or any modification accepted by the purchaser, has been duly completed and proof satisfactory to the party of the second part has been furnished to it, the said note shall, subject otherwise to the terms of said collateral agreement, be returned to the party of the first part.

4. That in event of a default in the performance of the contract between Maxim Munitions Corporation and Officine di Villar Perosa, or any modification thereof accepted by the purchaser, the party of the second part may, at its option, immediately reduce said guaranteed note to cash by taking such action, legal or otherwise, as may be necessary against either maker or guarantor, or both, and shall then hold for its protection the amount of money thus received together with the other money heretofore deposited with it under the terms of the collateral agreement of April 3rd, 1917, as fully and completely as though all of the money derived from said note had been originally deposited with it under such collateral agreement.

5. That if and when the contract between Maxim Munitions Corporation and Officine di Villar Perosa, or any modification thereof accepted by the purchaser, shall have been completed to such an extent and the cartridges shall be accepted and paid for, either by actual payment or application of the advance payment so that all of the contract price shall have been thus earned and paid, except an amount equal to said note, then, as the said contract is further completed, the amounts subsequently earned and allowed by Officine di Villar Perosa shall be credited upon said note.

6. The note given as collateral under this agreement shall not be held or applied by the party of the second part to secure any liability of the party of the second part under any bond of the party of the second part issued as surety for the Maxim Munitions Corporation, except the bond [fol. 49] referred to herein; provided that this clause shall not be construed to change the relation of the second party to the Maxim Munitions Corporation as defined in the said collateral agreement of April 3rd, 1917.

In Witness whereof the parties hereto have caused these presents to be executed by their respective officers duly au-

thorized hereunto by order of their board of directors and their official seal to be hereunto affixed by like order the day and date first herein mentioned.

United States Cartridge Company, by Paul Butler, Treas. Attest: C. E. Hoxie, [Secretary.]* Agent.
Fidelity and Deposit Company of Maryland, by F. A. Bach, Vice-Pres. Attest: Frank (?) Welsh, Asst. Secretary.

[fol. 50] EXHIBIT D TO PETITION

$153,125.00. Lowell, Mass., October 20th, 1917.

Ten (10) days after demand we promise to pay to the order of Fidelity and Deposit Company of Maryland One Hundred Fifty-three Thousand One Hundred Twenty-five Dollars without interest at its Home Office in Baltimore, Md.

This note is given in pursuance of and subject to the terms and conditions of a certain collateral agreement between the maker and payee dated the 20th day of October, 1917.

Value Received.

United States Cartridge Co., by Paul Butler, Treas.

The undersigned National Lead Company in consideration of the acceptance of the within note and the terms thereof by the payee hereby guarantees the payment of the same when due and in accordance with its terms and conditions.

National Lead Company, by E. J. Cornish, President.
H. R. Fortmeyer, Treasurer.

[fol. 51] EXHIBIT E TO PETITION

War Department, Office of the Chief of Ordnance,
Procurement Division, Washington

PL P6489-1489SA. December 20, 1918.

U. S. Cartridge Co., Lowell, Mass.

GENTLEMEN:

1. By direction of the Chief of Ordnance you are requested in the public interest immediately to suspend fur-

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[*Word enclosed in brackets stricken in copy.]

ther operations under your contract with the United States War-Ord-No. P6489-1489SA, except such operations as may be necessary to complete delivery thereunder of a total (including all deliveries heretofore made) of "16,100,000 .45 caliber Pistol Ball Cartridges, Model 1911." In no event will the United States accept delivery after April 1, 1919; the balance undelivered on such date will be automatically cancelled by this notice. You are also requested, except for the purpose of completing such deliveries or in cases of proved necessity, to order no further materials or facilities, enter into no further sub-contracts, make no further commitments, and incur no further expenses in connection with the performance of said contract.

2. This request is made with a view to the negotiation of a supplemental contract providing for the modification, settlement and adjustment of your existing contract, in a manner which will permit of a more prompt settlement and payment than will be practicable under the terms of said existing contract.

3. Please acknowledge receipt of this notice immediately and indicate your decision as to compliance with or rejection of this request. Forward your acknowledgment in [fol. 52] duplicate to the District Office indicated below. Upon notice of your compliance a representative of the Ordnance Department will forthwith take up with you the proposed negotiation.

Respectfully, by Dale Bumstead, Lt. Col. Ord. Dept. U. S. A., Contracting Officer.

Boston, Mass., District Ordnance Office.

Form J Special.
PS.

[fol. 53] EXHIBIT F TO PETITION

War Department, Office of the Chief of Ordnance,
Procurement Division, Washington

Suspension Request

PL No. P12289-3034A. December 12, 1918.

United States Cartridge Co., Lowell, Mass.

GENTLEMEN:

1. By direction of the Chief of Ordnance you are requested in the public interest immediately to suspend further operations under your contract with the United States, War-Ord-No. P12289-3034-A, and to order no further materials or facilities, and except in cases of proved necessity, enter into no further sub-contracts, make no further commitments, and incur no further expenses in connection with the performance of said contract.

2. This request is made with a view to the negotiation of a supplemental contract providing for the cancellation, settlement and adjustment of your existing contract, in a manner which will permit of a more prompt settlement and payment than will be practicable under the terms of said existing contract.

3. Please acknowledge receipt of this notice immediately, and indicate your decision as to compliance with or rejection of this request. Upon notice of your compliance, a representative of the Ordnance Department will forthwith take up with you the proposed negotiation.

Respectfully, by Dale Bumstead, Lt. Col. Ord. Dept.,
U. S. A., Contracting Officer.

Boston, Mass., District Ordnance Office.

Form H.

[fol. 54] EXHIBIT G TO PETITION

War Department, Office of the Chief of Ordnance,
Procurement Division, Washington

"Suspension Request"

PL—No. GA126. Dec. 16, 1918.

United States Cartridge Co., Lowell, Mass.

GENTLEMEN:

1. By direction of the Chief of Ordnance, you are requested in the public interest immediately to suspend further operation under your contract with the United States, War-Ord-No. GA 126, except such operations as may be necessary to complete material now in process in your plant but in no case shall work continue beyond January 31, 1919, and to order no further materials or facilities, and except in cases of proved necessity, enter into no further sub-contracts, make no further commitments, and incur no further expenses in connection with the performance of said contract.

2. This request is made with a view to the negotiation of a supplemental contract providing for the cancellation, settlement and adjustment of your existing contract, in a manner which will permit of a more prompt settlement and payment than will be practicable under the terms of said existing contract.

3. Please acknowledge receipt of this notice immediately, and indicate your decision as to compliance with or rejection of this request. Forward your acknowledgment in duplicate to the District Office indicated below. Upon notice of your compliance, a representative of the Ordnance Department will forthwith take up with you the proposed negotiation.

Respectfully, by Richard Swartwout, Major, Ord. Dept., U. S. A., for Contracting Officer.

Boston District Ordnance Office.

Form H.

[fol. 55] EXHIBIT H TO PETITION

War Department, Office of the Chief of Ordnance, Procurement Division, Washington

"Suspension Request"

December 14, 1918.

PL No. P12621-3124A.

United States Cartridge Co., Lowell, Mass.

GENTLEMEN:

1. By direction of the Chief of Ordnance, you are requested in the public interest immediately to suspend further operations under your contract with the United States War-Ord-No. P12621-3124A except such operations as may be necessary to complete material now in process in your plant but in no case shall work continue beyond January 31, 1919, and to order no further materials or facilities, and except in cases of proved necessity, enter into no further sub-contracts, make no further commitments, and incur no further expenses in connection with the performance of said contract.

2. This request is made with a view to the negotiation of a supplemental contract providing for the cancellation, settlement and adjustment of your existing contract, in a manner which will permit of a more prompt settlement and payment than will be practicable under the terms of said existing contract.

3. Please acknowledge receipt of this notice immediately, and indicate your decision as to compliance with or rejection of this request. Forward your acknowledgment in duplicate to the District Office indicated below. Upon notice of your compliance, a representative of the Ordnance Department will forthwith take up with you the proposed negotiation.

Respectfully, by Richard Swartwout, Major, Ord. Dept., U. S. A., Contracting Officer for U. S. A.

Boston District Ordnance Office.
PP.

Form H.

[fol. 56] EXHIBIT I TO PETITION

Computation of Excess Profits, War Profits, and Income Taxes of the United States Cartridge Company for 1918

Correct net income	$768,659.37
Invested capital	4,580,808.44
Excess profits credit	369,464.68
War profits credit	461,080.84

Excess Profits Tax

Net income	$768,659.37
Less Excess Profits credit	369,464.68
Taxable at 30%	$399,194.69
Excess Profits tax	119,758.41

War Profits Tax

Net income	$768,659.37
Less War Profits credit	461,080.84
Taxable at 80%	$307,578.53
Tax	246,062.82
Less Excess Profits tax	119,758.41
War Profits tax	$126,304.41
Total Excess Profits and War Profits tax	246,062.82

Income Tax

Net income		$768,659.37
Less		
War Profits and Excess Profits tax	246,062.82	
Exemption	2,000.00	
		248,062.82
Taxable at 12%		$520,596.55
Income Tax		62,471.59
War Profits and Excess Profits tax		246,062.82
Total Tax		$308,534.41

[fol. 57] II. General Traverse—Filed January 14, 1928

And now comes the Attorney General, on behalf of the United States, and answering the claimant herein, denies each and every allegation therein contained; and asks judgment that the petition be dismissed.

Herman J. Galloway, Assistant Attorney General.

F. K. D.

III. Argument and Submission—December 9, 1930

On December 9, 1930, this case was argued and submitted on the merits by Mr. H. LeBaron Sampson for the plaintiff, and Messrs. Fred K. Dyar and Isadore Graff, for the defendants.

[fol. 58] IV. **Special Findings of Fact, Conclusion of Law, and Opinion of the Court by Booth, Ch. J.**—Filed April 6, 1931

This is a tax case. The issues involved concern the proper valuation of inventory and allowance of a claimed deduction from gross income for loss of useful value of factory buildings erected upon leased ground. Plaintiff in its tax return for the year 1918 valued its inventory at market and not cost. The commissioner valued inventory at cost, on the basis of a firm sales contract to pay cost of materials purchased to perform a contract. Plaintiff claimed obsolescence of buildings erected on leased ground, the claim being predicated upon the fact of termination of the war in that year, the buildings having been erected to perform war contracts. The commissioner granted annual depreciation of such a sum as at the end of the ten-year term of the lease returned to plaintiff their original cost.

The case was heard upon a report of a commissioner, from which the court makes the following

Special Findings of Fact

1. The plaintiff, United States Cartridge Company, now is and at all times hereinafter mentioned was, a corpora-

tion organized and existing under the laws of the Commonwealth of Massachusetts, and now has its principal place of business at Boston, Massachusetts. The plaintiff has at all times borne true allegiance to the Government of the United States and has not in any way voluntarily aided, abetted, or given encouragement to rebellion against said Government. The plaintiff is the sole and absolute owner of the claim involved in this suit, and has made no transfer or assignment of said claim or any part thereof.

2. In the year 1918 the plaintiff was engaged in the manufacture of ammunition chiefly for small arms. The principal part of its business was the manufacture of ammunition for use in the World War. It also produced some ammunition for commercial purposes. Its accounts were [fol. 59] kept on an accrual basis as distinguished from a cash basis.

3. The plaintiff kept its accounts and made its tax returns on a calendar-year basis. It had duly elected that inventories should be priced for its tax returns for the year 1918 at "cost or market, whichever is lower." On March 22, 1919, the plaintiff filed on Treasury Form 1031-T a tentative income and profits tax return for the calendar year 1918, in which its tax was estimated to be $1,200,000. On December 16, 1919, the plaintiff filed on Treasury Form 1120-A its income and profits tax return for the calendar year 1918, showing a net income of $1,020,374.59, invested capital of $4,676,525.21, excess-profits credit of $377,122.02, war-profits credit of $470,652.52, and a tax of $509,209.29, which tax was thereafter duly assessed on January 23, 1920. Under its tentative return the plaintiff paid the sum of $900,000, as follows: March 16, 1919, $300,000; June 15, 1919, $300,000; and September 15, 1919, $300,000. The sum of $390,790.71, the difference between the sum of $900,000 so paid and the tax of $509,209.29 so shown, was subsequently applied in part payment of taxes assessed for the year 1919.

4. Upon the review and audit of plaintiff's said return the Commissioner of Internal Revenue determined the plaintiff's net income for 1918 at $1,792,432.58, invested capital at $4,580,808.44, excess-profits credit at $369,464.68, war-profits credit at $461,080.84, total tax as $1,152,123.53, and additional tax at $642,914.24. Plaintiff was notified of

cartridges to 125,000,000, the penal sum of said bond and the respective liabilities of the sureties thereon were, by agreement of the interested parties, reduced by one-half, and one-half of the amount deposited with the sureties was returned to Officine di Villar Perosa. Copy of said bond is attached to the agreed statement of facts and made a part hereof by reference.

11. On or about October 20, 1917, the plaintiff, with the assent of the Maxim Munitions Corporation, entered into agreements dated October 20, 1917, with each of the sureties on the bond referred to in the preceding finding, under which the Maryland Casualty Company paid to the plaintiff $306,250 and each of the other two sureties paid to [fol. 61] the plaintiff $153,125 of the cash which had been deposited with them by the Maxim Munitions Corporation as aforesaid, being a total payment to the plaintiff of $612,500. For such moneys the plaintiff gave notes to the respective sureties, which were guaranteed by the National Lead Company, a corporation organized under the laws of the State of New Jersey. A true copy of the contract between plaintiff and the Fidelity and Deposit Company is annexed to the petition filed in this cause, marked "Exhibit C," and is made a part hereof by reference, and a true copy of the note given to the said surety and of the guaranty by the National Lead Company is annexed to the said petition, marked "Exhibit D," and is made a part hereof by reference. Contracts and notes in similar form were given by the plaintiff to the other sureties for amounts corresponding to the moneys received by the plaintiff from the respective sureties. The plaintiff has not paid said notes amounting to $612,500.

12. Under the contracts referred to in Finding 10 said cartridges were to be inspected by inspectors to be designated by Officine di Villar Perosa at the plant where they were being manufactured. Officine di Villar Perosa was represented in the United States by Joseph S. Josephs, who signed said contract of March 19, 1917, as its agent. In accordance with instructions received by the Maxim Munitions Corporation from Josephs all matters relating to the inspection and acceptance and directions for shipping of the cartridges were handled by the Italian Mili-

tary Mission, which represented the Italian Government in the United States and had an office in New York City.

13. The monthly deliveries of cartridges which were made under said contract of March 19, 1917, and its amendments were as follows:

July, 1917	
Aug. "	252,000
Sept. "	3,024,000
Oct. "	1,512,000
Nov. "	1,512,000
Dec. "	252,000
Jan., 1918	None.
Feb. "	756,000
Mar. "	5,544,000
Apr. "	4,536,000
May "	7,560,000
June "	8,064,000
July "	8,820,000
Aug. "	10,080,000
Sept. "	12,600,000
Oct. "	9,072,000
Nov. "	10,080,000
	5,796,000
	89,460,000

On November 22, 1918, Camillo Cerruti, then the chief of the Italian Military Mission and in charge on behalf of the Kingdom of Italy of all matters relating to the delivery and acceptance of said cartridges, notified the Maxim Munitions Corporation that the contract with the Officine di Villar Perosa must be considered canceled on account of the failure of the Maxim Munitions Corporation to keep the terms of delivery. A question was raised as to the authority of Mr. Cerruti to cancel the contract, and on November 26, 1918, Officine di Villar Perosa, through Joseph S. Josephs, its duly authorized agent, requested the Maxim Munitions Corporation to discontinue the manufacture of cartridges without prejudice to any rights which the Maxim Munitions Corporation might have by reason of the request, and without prejudice to the rights of either party under the contracts. The Maxim Munitions Corporation then requested the plaintiff to dis-

[fol. 62] continue the manufacture of the cartridges. The manufacture of such cartridges was accordingly stopped by the plaintiff on November 26, 1918.

14. In November and December, 1918, the Maxim Munitions Corporation made requests upon both Joseph S. Josephs as agent of Officine di Villar Perosa and the Italian Military Mission that they proceed to accept deliveries under the contract between the Maxim Munitions Corporation and Officine di Villar Perosa. Neither Officine di Villar Perosa nor the Italian Military Mission was ready to accept and to pay for further deliveries of cartridges after November 26, 1918, and the officers of both the Maxim Munitions Corporation and the plaintiff had notice in November, 1918, of their refusal to accept further deliveries.

15. On December 7, 1918, Joseph S. Josephs as agent of Officine di Villar Perosa notified the Maxim Munitions Corporation that he had received instructions from Officine di Villar Perosa that the Maxim Munitions Corporation take up the contract with the Italian Military Mission and that whatever action the Military Mission might take as to the final disposition of the contract would be approved by both his principal and himself. The Italian Military Mission adhered to the position that Officine di Villar Perosa had a right to cancel the contract of March 19, 1917, as amended, *an* account of delays in deliveries, and refused to recognize any legal obligation either to accept further deliveries of cartridges or to make any compensation for the materials on hand intended for use in completing the contract or for labor expended on such materials. The plaintiff, through its officers and employees, had notice before the end of 1918 of this attitude of the Italian Military Mission.

16. The Maxim Munitions Corporation was insolvent before the end of 1918 and was not able to accept and pay for further deliveries of cartridges under its contract with the plaintiff or to pay for the materials which the plaintiff had on hand intended for use in said contract. The Maxim Munitions Corporation also owed the plaintiff at this time more than $300,000 for cartridges delivered under the contract which it was unable to pay. The officers of

the plaintiff were aware of the inability of the Maxim Munitions Corporation to perform its contract and to pay for said materials before the end of 1918.

17. On May 29, 1919, a petition of involuntary bankruptcy was filed against said Maxim Munitions Corporation (the name of which was changed to Maxim Corporation on March 5, 1919), in the District Court of the United States for the Southern District of New York, and on June 18, 1919, said corporation was adjudicated a bankrupt. On July 10, 1919, plaintiff acquired a conveyance bearing said date from the receiver in bankruptcy of said Maxim Munitions Corporation of the rights of said corporation under the contracts dated March 19, 1917, and amendments thereto dated May 31, 1917, and December 14, 1917, between the Maxim Munitions Corporation and Officine di Villar Perosa. On March 16, 1926, for the sum of $61,250 the plaintiff acquired an unconditional conveyance bearing said date from the trustee in bankruptcy of said Maxim Munitions Corporation of the interest of the bankrupt estate in said contracts, and all rights of action thereunder against the Officine di Villar Perosa, the Kingdom [fol. 63] of Italy, and the sureties on the bond with the interest of the bankrupt estate in the collateral security held by such sureties.

After July, 1919, the plaintiff attempted to negotiate a settlement with the Italian Government, but has never reached any such settlement nor realized anything from such negotiations. Officine di Villar Perosa had no known assets in the United States and no known place of business where service could be made upon it.

A copy of each conveyance mentioned in this finding is annexed to the agreed statement of facts and made a part hereof by reference.

18. In the spring of 1922 it was reported to the officers of the plaintiff that Dr. Roland Ricci, the Italian ambassador to the United States, had reviewed the history of the plaintiff's claim under the conveyance of July 10, 1919, and was disposed to recommend to his Government a settlement on the basis of the Italian Government receiving $100,000 in cash and all of the completed cartridges, re-

leasing all obligations of the surety companies, and securing such a release from Officine di Villar Perosa. As a part of the proposed settlement, the plaintiff was to be released by the surety companies from all liabilities on its notes and agreements, but was to retain $512,500 of the sum of $612,500 paid to it as aforesaid and all material on hand, except the finished cartridges. The plaintiff was willing to agree to such a settlement but the Italian Government and Officine di Villar Perosa did not approve it. No such settlement has ever been carried out and negotiations with respect to it were dropped. The plaintiff has received nothing under the conveyances described above. In October, 1923, the three sureties on the bond brought suits against the plaintiff in the Superior Court for Suffolk County, Massachusetts, upon the respective notes given to them. These suits are still pending undetermined.

19. During the war the United States Government demanded priority in shipments of ammunition to it under its contracts with the plaintiff, with the result that the plaintiff was delayed in its manufacture of cartridges under its contract with Officine di Villar Perosa and the quantities specified in said contract for monthly delivery were not met. All this time, however, Officine di Vollar Perosa kept pressing the plaintiff for deliveries and accepting deliveries of any quantity the plaintiff could produce up to the time of the armistice, and at the time of the armistice three-fourths of the cartridges to be manufactured under the said contract had been completed and delivered. The plaintiff and the Maxim Munitions Corporation, in its negotiations for settlement of the said contracts, took the position that the contracts had not been breached and that they were entitled to secure a settlement in accordance with the terms thereof. Mr. Butler Ames, treasurer of the plaintiff corporation from September, 1918, to January, 1920, went to Italy for the purpose of effecting a settlement of the said contract. He resigned from the plaintiff corporation in January, 1920, and at that time the plaintiff still hoped to come to a settlement and had not abandoned its efforts in that direction.

20. On December 31, 1918, the plaintiff had on hand approximately 4,000,000 completed 9-millimeter cartridges

which had not been delivered or paid for and a quantity of materials and work in process acquired and worked for the purpose of manufacturing cartridges to be delivered under the contracts for 9-millimeter cartridges. The plain-
[fol. 64] tiff had no purchaser to whom the completed cartridges could be sold as they were of a special type used only by the Italian Government. Most of the material and work in process on hand which had been intended for use under the contract between the plaintiff and the Maxim Munitions Corporation was not suitable for use in manufacturing other ammunition without first being scrapped as its dimensions were suitable only for 9-millimeter cartridges. On December 31, 1918, the value of such cartridges, material, and work in process, pricing the cartridges at the amount to be paid for finished cartridges under the contract between the plaintiff and the Maxim Munitions Corporation, and pricing the material and work in process at cost, was $274,659.78. On December 31, 1918, the value of said cartridges, materials, and work in process was $79,297.11, at the market without taking into consideration any special value of such goods to the plaintiff arising from said contract, if any such special value existed. In determining the plaintiff's income and profits taxes for 1918 the Commissioner of Internal Revenue valued such cartridges, material, and work in process as of December 31, 1918, at $274,659.78. The plaintiff claimed that said articles should be valued at said date at $79,297.11. Any reduction in such value below the $274,659.78 used by the Commissioner of Internal Revenue would cause an equal reduction in the taxable income of the plaintiff for the year 1918, as determined by the Commissioner of Internal Revenue. The plaintiff has never been able to sell the completed 9-millimeter cartridges and they are still on hand, except for a few samples. All the work in process and the other material on hand intended for use in completing the contract with the Maxim Munitions Corporation have been sold or used by the plaintiff. The plaintiff did not realize cost for it or anything more than the value of the materials.

21. During the year 1918 the plaintiff was engaged in manufacturing .45-caliber cartridges and artillery primers

to be supplied to the United States under certain contracts and understandings made by the plaintiff and representatives of the Chief of Ordnance, acting under the authority of the Secretary of War. These contracts and understandings were as follows:

(a) A contract known as P6489-1489 Sa, dated May 6, 1918, executed in accordance with section 3744 of the Revised Statutes, providing for the delivery by the plaintiff to the United States of 60,100,000 .45-caliber cartridges. A true copy of said contract marked "Exhibit 11" is attached to the agreed statement of facts filed on November 2, 1928, and made a part hereof by reference.

(b) An understanding known as the first supplemental contract to contract P6489-1489 Sa, made in the year 1918 and before November 11, 1918, by the plaintiff and officers of the Ordnance Department, acting under authority of the Secretary of War, providing for the delivery by the plaintiff to the United States of 75,000,000 .45-caliber cartridges, in addition to those provided for by contract P6489-1489 Sa. The terms of said understanding are shown in a draft of contract marked "Exhibit 12" attached to said agreed statement of facts and made a part hereof by reference. Said understanding was never signed by the parties as required by section 3744 of the Revised Statutes.

[fol. 65] (c) A contract known as P12289-3034A, dated July 20, 1918, executed in accordance with section 3744 of the Revised Statutes, providing for the delivery by the plaintiff to the United States of 8,760,000 49-grain artillery primers. A true copy of said contract marked "Exhibit 13" is attached to said agreed statement of facts and made a part hereof by reference.

(d) A contract known as GA-126, dated August 22, 1917, and executed in accordance with section 3744 of the Revised Statutes, providing for the delivery by the plaintiff to the United States of 5,000,000 110-grain primers, and a supplementary understanding in the form of two letters dated November 15, 1917, and November 28, 1917, increasing the price to be paid for said primers. True copies of said contract and letters marked "Exhibits 14, 15, and 16," respectively, are attached to said agreed statement of

facts and made a part hereof by reference. Said supplementary understanding was made by officers of the Ordnance Department acting under authority of the Secretary of War.

(e) A contract known as P12621-3124A, dated July 25, 1918, executed in accordance with section 3744 of the Revised Statutes, providing for the delivery by the plaintiff of 1,000,000 110-grain artillery primer bodies to the United States. A true copy of said contract marked "Exhibit 17" is annexed to said agreed statement of facts and made a part hereof by reference.

All of the foregoing are hereinafter referred to as contracts.

22. In December, 1918, the plaintiff received notices from the Ordnance Department requesting suspension of production under said contracts with the United States. Each of these notices requested the plaintiff to suspend immediately further operations under the contract to which it related (except, in one case, for the completion of a specified limited number of cartridges), and stated that the request was made with a view to negotiation of a supplemental contract providing for the cancellation (or modification), settlement, and adjustment of the existing contract in a manner which would permit of a more prompt settlement and payment than would be practicable under the existing contract. True copies of said notices are annexed to the petition filed in this cause, marked "Exhibits E, F, G, and H," respectively, and are made a part hereof by reference. The plaintiff complied with the requests contained in these notices.

23. On December 31, 1918, the plaintiff had on hand materials and work in process acquired and worked for the purpose of manufacturing the articles specified in the contracts, but which would not be required in making the reduced quantities of such completed articles which the plaintiff was to deliver according to the terms of such suspension notices. The materials and work in process intended for use under said contracts which are referred to in the petition are the materials which would have been incorporated into the completed articles if the work had

not been suspended. Such articles were described in the settlement of the contracts as direct materials. Consumable supplies, such as coal, oil, and similar supplies, which would have been used up in producing the articles but would not have been incorporated into the finished products, were described in such settlements as indirect materials. No issue is raised in the case as to the valuation of such indirect materials.

[fol. 66] 24. There was no market on December 31, 1918, for completed articles of the kind specified in said contracts, and it was not possible for the plaintiff to use such materials and work in process advantageously by manufacturing the same into the articles for which they had been intended. There was no way in which the plaintiff could get for its inventories what these inventories had cost the plaintiff except by settlements with the defendant. The material in these inventories was not salable at cost or anyway near cost.

25. During the year 1918 no settlement was made of any of such contracts of the plaintiff and no negotiations for such settlement took place other than the suspension requests, copies of which are annexed to the petition marked "Exhibits E, F, G, and H," and are made a part hereof by reference.

26. No policy had been adopted by the War Department permitting separate settlements for inventories under suspended contracts in cases where the parties could not agree as to the settlement of a contract as a whole until the issue by the War Department of Supply Circular No. 19, dated March 6, 1919.

27. In addition to the claims which the plaintiff had against the defendant for the cost of unused materials on hand and work done upon the same, the plaintiff had claims under each of said contracts for substantial amounts for other items of damage or compensation. These other claims remained unsettled until the time of the final settlements under the respective contracts. The first of such final settlements took place in December, 1921.

28. In February, 1919, the Government assigned a committee to the plaintiff's plant for the purpose of adjusting and settling the contracts between the plaintiff and the

Government. The said committee was dissolved in September, 1919, and the detail work of effecting a settlement was carried on by the Boston District Claims Board, a governmental agency. There were numerous changes in the personnel of the Boston District Claims Board while negotiations for settlement of the plaintiff's contracts were being conducted. In its negotiations for settlement, the plaintiff also dealt with governmental agencies in Washington, such as the contracting officer, the Ordnance Department Claims Board, the Board of Contract Adjustment, and the War Department Claims Board.

29. The plaintiff had negotiations with the Boston District Claims Board, an agency of the War Department, which resulted in 1920 in an agreement that the defendant would take over and pay for the plaintiff's inventory of direct materials on hand under contract P6489-1489 Sa and the first supplemental contract thereto.

30. Contract P6489-1489 Sa, which was executed in accordance with statutory requirements, and the supplement to it, which was not so executed, were settled together. This supplement provided for a change in the powder load of certain of the cartridges to be delivered under the original contract, for an increase in the price of such cartridges, and for delivery of an increased quantity. The War Department treated the original contract as so amended as within the provisions of the act of March 2, 1919, known as the Dent Act (40 Stat. 1272), and settled the contract and its amendment under procedure established to cover contracts not executed in accordance with statutory requirements.

[fol. 67] 31. In March and April, 1920, agreements with the defendant for acceptance of and payment for the plaintiff's inventories of direct materials on hand under contracts P12289-3034A, GA-126, and P12621-3124A were made in the form of supplemental contracts providing for a method of determining the amounts to be paid to the plaintiff on account of the suspension of production under said contracts. The contracts mentioned are made a part hereof by reference.

32. In the year 1920 the defendant, acting through the War Department, took over the greater part of the direct materials and work in process under said contracts and made payment for the same at cost to the plaintiff except as

said determination by letter dated December 4, 1925. A true copy of so much of said letter as is pertinent to the issues in this suit is annexed to the petition herein marked "Exhibit A," and made a part hereof. The commissioner's determination of the plaintiff's invested capital, excess-profits credit, and war-profits credit, and his determination of income with respect to all items other than those on which the petition is based are accepted by both parties as correct for the purposes of this case.

5. In determining the income of the plaintiff for the year 1918, the Commissioner of Internal Revenue placed valuations upon certain goods on hand at the end of the year which were largely in excess of the valuations claimed by the plaintiff to be correct, and also disallowed a deduction claimed by the plaintiff of a portion of the cost of certain buildings erected by the plaintiff on leased land.

6. The additional tax of $642,914.24 determined by the commissioner as stated above was duly assessed upon the plaintiff on January 16, 1926. Certain overpayments of taxes made by the plaintiff for the years 1917 and 1919, amounting to $412,563.90, were applied upon said additional assessment. On March 24, 1926, the collector of internal revenue for the district of Massachusetts demanded payment of the remainder, $230,350.34, and on March 31, 1926, the plaintiff paid said remainder to said collector under protest.

7. The plaintiff filed with the Commissioner of Internal Revenue waivers of its right to have its taxes for 1918 assessed within the statutory period, including a waiver dated December 27, 1923, filed on December 28, 1923, and a waiver dated November 1, 1924, filed on November 12, 1924, and including also certain subsequent waivers which were in force when the assessment of additional taxes was made on January 16, 1926.

[fol. 60] 8. On February 29, 1924, the plaintiff filed a claim for the refund of $451,839.51 paid on account of taxes for the year 1918. The Commissioner of Internal Revenue disallowed said claim on January 20, 1926. On January 25, 1927, the plaintiff filed a claim for the refund of $843,589.12 paid on account of taxes for the year 1918. The Commissioner of Internal Revenue disallowed said claim on April 11, 1927.

A true photostat copy of said claim is annexed to the agreed statement of facts filed on November 2, 1928, marked "Exhibit 2," and is made a part hereof by reference.

9. By a contract in writing dated October 5, 1917, between the plaintiff and the Maxim Munitions Corporation, a Delaware corporation, the plaintiff agreed to manufacture and deliver certain 9-millimeter cartridges which the Maxim Munitions Corporation had previously contracted to furnish to the Officine di Villar Perosa, an Italian corporation. These cartridges were of a military type and were to be used by the Italian Government in the prosecution of the World War in which that Government was engaged. The contract between the Maxim Munitions Corporation and Officine di Villar Perosa, which was dated March 19, 1917, provided for the delivery of 250,000,000 of such cartridges in instalments. This contract was twice amended by contracts dated May 31, 1917, and December 14, 1917, respectively. The last amendment reduced the quantity to be furnished to 125,000,000 and substituted a schedule of deliveries under which 119,000,000 cartridges were to be delivered in the months of November, 1917, to May, 1918, inclusive. The remaining 6,000,000 cartridges had been delivered before November, 1917. Copies of contracts and amendments thereof are in the record and are by reference made part of this finding.

10. The faithful performance of the contract dated March 19, 1917, between the Maxim Munitions Corporation and Officine di Villar Perosa, was secured by a bond dated March 22, 1917, executed by the Maxim Munitions Corporation, principal, and the Maryland Casualty Company, the Fidelity and Deposit Company of Maryland, and the United States Fidelity & Guaranty Company, all of Maryland, sureties in the penal sum of $1,531,250. The Maxim Munitions Corporation deposited with each of the sureties on said bond cash to the full amount of the liability of such surety under said bond, using for the purpose an advance payment of $1,531,250, which had been made to it in accordance with the contract of March 19, 1917. After the amendment of December 14, 1917, to the said contract of March 19, 1917, reducing the quantity of

plaintiff received a letter from the Boston District Ordnance Office, signed by the ordnance district chief, stating that the various claims boards would probably cease to exist on September 30, 1919. About August 20, 1919, the plaintiff received a letter from the Boston District Claims Board stating that that board would be unable to consider any claims which were not presented before September 30, 1919. It was impossible for the plaintiff to get its claims completed before September 30, 1919. The Board was in fact, however, continued after that date.

37. Soon after March 18, 1920, the plaintiff received a letter from the Boston District Claims Board stating that, from the most reliable information which the board was able to secure, outstanding appropriations on which it would be possible to pay the plaintiff's claims would be canceled on June 30, 1920, and that, in the event of the cancellation of the allotments occasioned by the expiration of the appropriation period, funds could be secured only by special act of Congress. About May 22, 1920, the plaintiff received a letter from the Boston District Claims Board stating that its office had been directed by the Claims [fol. 69] Board at Washington to notify contractors that the appropriations allotted for settlement of claims on suspended contracts would lapse on June 30, 1920, and thereafter payment could only be secured through agencies other than the War Department. It was not possible for the plaintiff to complete the settlement of its claims by June 30, 1920. About January 6, 1921, the plaintiff received a letter from the office of the Chief of Ordnance at Washington inclosing a copy of a memorandum dated December 21, 1920, from Newton D. Baker, Secretary of War, to the Assistant Secretary of War. This memorandum stated that the preceding year the department had urged upon Congress that appropriations be made available during the current year for the payment of settlements of war-time contracts and that Congress had done so and the funds were available until June 30, 1921. The memorandum also stated that the department would not ask Congress to extend this privilege and that claimants should be notified that appropriations lapsed on June 30, 1921. It was not possible for the plaintiff to reach settlements of the contracts before June 30, 1921. As it turned out, the appropriations were extended

beyond June 30, 1921, and the plaintiff received payments after that date.

38. The plaintiff eventually obtained final settlement of all the contracts under written awards or agreements made by or under the authority of the Secretary of War excepting, however, a claim under contract GA-126, relating to the price of articles which had been delivered. The dates of such awards or agreements and the total amounts allowed in each for direct materials, worked and unworked, for labor and overhead on worked direct materials and for other claims, are stated below. The amounts allowed for materials include the items which had been paid for in 1920 as stated in Finding 32.

	Unworked direct materials	Worked direct materials	Labor and overhead	Other claims
Contract P6489-1489 Sa and supplement: Final award dated Dec. 23, 1921; total awarded, $907,546.94	$442,153.76	$100,040.35	$78,487.01	$286,865.82
Contract P12289-3034A: Final settlement contract approved Feb. 6, 1922; total settlement agreed upon, $175,160.86	23,581.72	57,169.58	22,254.09	72,155.47
Contract GA-126: Final settlement contract dated June 8, 1922; total settlement agreed upon $31,098.53	3,699.59	1,504.32	3,247.02	22,647.60
Contract P12621-3124A: Final settlement approved Dec. 23, 1921; total settlement agreed upon, $40,812.02	19,457.08	9,456.03	3,947.87	7,951.04
Totals	488,892.15	168,170.28	107,935.99	389,619.93

Total allowed on all items on above contracts $1,154,618.35. In the final settlements made in 1921 and 1922, the United States reimbursed the plaintiff for the cost of certain portions of its inventory or for a part of said cost less the salvage value of such portions, and in the latter case the plaintiff retained the material for which it had been so reimbursed.

39. The War Department withheld certain sums due to the plaintiff under two of said final settlement contracts, claiming the right to withhold the same on account of alleged overpayments for completed articles delivered under contract GA-126. The question at issue was whether an

agreement made by certain letters exchanged between the [fol. 70] Ordnance Department and the plaintiff, providing for an increase of 1.8 cents in the price of each primer delivered under contract GA-126, was valid. Most of the primers delivered under contract GA-126 had been paid for in accordance with this agreement. The War Department claimed that the payment of the increased amount was illegal and withheld $24,108.66, being the entire unpaid amount due to the contractor under the settlement contract relating to contract GA-126, and $28,482.39 of the balance due under the settlement contract relating to contract P12289-3034A. The plaintiff subsequently brought suit in the Court of Claims to recover the amounts withheld, recovered judgment in full in the year 1926, and received payment.

40. The amounts allowed for direct materials and for labor and overhead on such materials in the final settlements of the contracts included allowances for some material which was not in the inventory of the plaintiff at the end of the year 1918 because at that time it was the property of subcontractors. This material later became the property of the plaintiff through settlements made by the plaintiff with the subcontractors.

41. The value on December 31, 1918, of the material and work in process owned by the plaintiff which had been acquired and worked for the purpose of manufacturing the articles specified in the contracts and understanding, pricing at cost those portions of the same which were subsequently taken over at cost by the United States, or for which the plaintiff was subsequently reimbursed at cost as stated above, pricing the material for which the plaintiff was paid a part of the cost at the amount received therefor in said settlements, and pricing the remainder thereof at its fair market value on said December 31, 1918, was $732,088.62. The fair market value of said materials and work in process on December 31, 1918, without taking into consideration any special value of such goods to the plaintiff arising from said contracts, if any such special value existed, was $231,615.43. In determining the plaintiff's income and profits taxes for the year 1918, the Commissioner of Internal Revenue valued such materials and work in process as of December 31, 1918, at $732,088.62. The plain-

tiff claimed that said articles should be valued at $231,615.43. Any reduction in valuation of said materials and work in process below the amount used by the Commissioner of Internal Revenue would cause an equal reduction in the taxable income of the plaintiff for the year 1918.

42. The market value on December 31, 1918, of the plaintiff's inventory of materials and work in process intended for use under the contracts was $231,615.43.

43. For many years prior to the beginning of the World War in 1914 the plaintiff had been engaged in the manufacture of ammunition for small arms for ordinary commercial purposes. The business was principally carried on at Lowell, Massachusetts, in buildings on Lawrence Street, which the plaintiff rented from the Wamesit Power Company. There was also a small shooting range at South Lowell. The market for such ammunition was limited. The business was highly competitive and was not profitable in the years immediately preceding the war. The company [fol. 71] had a deficit in the years 1911, 1912, 1913, and 1914. In 1913 and 1914 the plaintiff employed between 350 and 400 persons.

44. For the purpose of filling war orders which the plaintiff had received and expected to receive while the war continued, the plaintiff constructed buildings upon the lands of the Wamesit Power Company at Lowell, and at South Lowell, Massachusetts, and equipped these buildings with machinery for the manufacture of ammunition for small arms and similar munitions of war, under an agreement in the following terms:

"Whereas, the United States Cartridge Company wishes to increase the size of some of the buildings now rented from the Wamesit Power Company and to erect new buildings and make other improvements on the property of the Wamesit Power Company, and the Wamesit Power Company does not wish to make the necessary investment therefor, it is therefore agreed that the United States Cartridge Company may erect and occupy such buildings for ten years from January first, nineteen hundred and fifteen, paying no rent therefor to the Wamesit Power Company for said ten years, and at the end of said ten years the buildings and improvements shall become the property of the Wamesit

Power Company and shall thereafter be subject to rental by the Wamesit Power Company.

"If the United States Cartridge Company shall desire to vacate said buildings or any part of them before the end of the term of ten years, the Wamesit Power Company shall give the United States Cartridge Company all possible assistance in renting said buildings for the remainder of the term of ten years, the rental to be paid to and be for the benefit of the United States Cartridge Company.

"The United States Cartridge Company shall pay the taxes on the buildings, shall keep the buildings fully insured, and in case of loss the United States Cartridge Company shall replace the buildings in as good condition as before, or if the United States Cartridge Company shall not desire to rebuild, the Wamesit Power Company shall have the option of taking the amount received from insurance and rebuilding or not."

45. The amount expended by the plaintiff in the construction of said buildings at Lowell and at South Lowell and the years in which said amounts were spent are as follows:

Year	Expenditures at Lowell	Expenditures at So. Lowell
1914	$0.00	$4,088.79
1915	296,256.40	295,457.37
1915 (garage)	41,017.03	.....
1916	99,657.20	65,950.49
1917	.....	72.21
	436,930.63	365,568.86
	.....	436,930.63
Total amount expended	.....	802,499.49

46. When the plaintiff built said new buildings it had no use for them except for war purposes. During the World War the plaintiff had a large and profitable business in ammunition intended for use in the war, first for European [fol. 72] governments, and later for the United States, after the United States entered the war. Its employees increased in number to 7,000 in 1916 and to about 15,000 in 1918. In 1913 and 1914, before the war began, the plaintiff occupied in its business 89,074 square feet of floor space at Lowell and South Lowell. During the war the plaintiff occupied said new buildings which it constructed to their capacity and also rented additional buildings from the

Wamesit Power Company. Some of the buildings which the plaintiff had occupied in 1914 were torn down to make room for said new buildings. By the end of 1916 the plaintiff was occupying 422,302 square feet of floor space at Lowell and South Lowell, of which 282,968 square feet were contained in said new buildings erected by the plaintiff and the remainder, 139,334 square feet, was rented from the Wamesit Power Company. After these buildings were constructed they were all used by the plaintiff up to the time when the United States entered the war and during the years 1917 and 1918.

47. Up to the time of the armistice the plaintiff had orders equaling its capacity and had no way of knowing when the demand for ammunition for war purposes would stop. After the armistice the plaintiff received no new orders for military ammunition and did not expect any. The plaintiff's officers had no expectation of continuing the production of military ammunition after the armistice except perhaps to clean up some material already in the plant and did not expect to so continue to any material extent.

48. In its income-tax return filed for the year 1916 the plaintiff claimed a deduction of $973,628.83 for amortization of its plant created for war purposes. In April, 1917, this return was examined by a revenue agent acting under the Commissioner of Internal Revenue, who notified the plaintiff that the cost of the war plant should be charged off over the period ending on December 31, 1924, and that only a proportionate part could be deducted in 1916. The plaintiff acquiesced in this view so far as such deduction in the year 1916 was concerned and filed an amended return for 1916 in accordance with it, and in consequence paid an additional tax for 1916 of $18,099.18.

49. The buildings with respect to which the plaintiff is claiming a loss of useful value are the leasehold buildings at Lowell and South Lowell, Massachusetts, which were erected by the plaintiff in the years 1914 to 1916 at a cost of $802,499.49 and which had an area of 282,968 square feet. The depreciation allowed in the settlement of the plaintiff's income and profits taxes for the years 1914 to 1917, inclusive, on account of the cost of the buildings, was $197,107.74. In the settlement of its 1918 income and profits taxes the plaintiff claimed that the value on December 31,

1918, of the plaintiff's right to use said buildings for peace-time purposes for the remainder of the term of the lease was $190,969.86, and asserted that it was entitled to deduct as a loss of useful value for the year 1918 the difference between the depreciated value of the said buildings (cost $802,499.49, less depreciation to December 31, 1917, of $197,-107.74) and the alleged residual value thereof, $190,969.86, making a deduction of $414,421.89. The Commissioner of Internal Revenue refused to allow any deduction for loss of useful value, ruling that the plaintiff was not entitled to such an allowance because it had not abandoned the use [fol. 73] of said buildings or permanently devoted them to a radically different use, but allowed $86,484.54 for depreciation of said buildings for the year 1918. The remainder of the plaintiff's claim of $414,421.89, namely, $327,937.35, was not alowed in any form. Said allowances for depreciation of $197,107.74 and $86,484.54 were reached by allowing depreciation on each of the buildings at a rate so calculated that at the expiration of the lease the cost of each building would be extinguished in equal annual instalments. The deduction from income for 1918 claimed by the plaintiff on account of the cost of said buildings erected on leased land was charged off on the plaintiff's books.

In the income-tax returns filed by the plaintiff for the years 1919 to 1924, inclusive, the plaintiff claimed deductions on account of the cost of the buildings erected by the plaintiff on land leased from the Wamesit Power Company aggregating $190,969.86, being the amount claimed by the plaintiff to be the residual value on December 31, 1918, of the right to use said buildings during the remainder of the lease. The total amount so claimed for the years 1919 to 1924 was allocated proportionately between said years. The Commissioner of Internal Revenue, in determining the taxes of the plaintiff for said years 1919 to 1924, increased the deduction for said years on account of the cost of said buildings by $327,937.35, the amount of the deduction which the commissioner had disallowed for the year 1918.

On January 16, 1926, when the assessment of additional taxes was made on the plaintiff for the year 1918, the commissioner had made no final determination of the income or profits taxes of the plaintiff for the years 1920 to 1924, inclusive, and the statute of limitations was not a bar to the assessment of proper taxes for such years and for the year

1919, as the plaintiff had filed agreements to waive the statute of limitations with respect to the years 1919, 1920, and 1921, to which said statute would otherwise have applied, valid as to the year 1919 until July 29, 1926, and as to the years 1920 and 1921 until December 31, 1926.

The respective floor areas of the garage and other buildings constructed at Lowell and the buildings constructed at South Lowell, and the amount of depreciation allowed thereon to December 31, 1918, by the Commissioner of Internal Revenue, are as follows:

	Floor area	Depreciation allowed to December 31, 1918
Garage	22,960 sq. ft.	$15,111.53
Other buildings at Lowell	156,960 sq. ft.	138,573.08
Buildings at So. Lowell	103,048 sq. ft.	129,907.67
	282,968 " "	283,592.28

50. After the armistice the plaintiff continued its commercial ammunition business. Its position with respect to this business was difficult, as each of the five munition manufacturers in the country had a capacity which was much greater than in peace times and each strove to get as much of the business as possible.

[fol. 74] 51. No income could be derived by renting the new buildings as there was no demand for buildings of this character. Most of the buildings rented from the Wamesit Power Company had been incorporated into the new buildings so that the two had to be used as a unit unless the plant was revamped, and this was not considered or done. Plaintiff had in the new buildings and in the buildings which it rented more space than it needed for its commercial ammunition business.

The actual sales of ammunition for 1924 were less than those for the preceding year. The plaintiff did fill the new buildings and those which it rented by manufacturing in addition to ammunition certain articles which the plaintiff had not made before the war, including radiators, radiator tubes, phonograph motors, paper boxes, and certain other articles. The volume of such other business was small compared with the plaintiff's ammunition business. Ap-

proximately nine-tenths of the plaintiff's sales were of ammunition in each of the years 1920 to 1924, inclusive. The plaintiff realized no net return from this other business but suffered a loss in the manufacture of each of such other lines of goods in each year. The plaintiff also made no profit from its manufacture of commercial ammunition after the war but suffered a loss on all its manufacturing operations in each of the years 1919 to 1924, inclusive.

52. From a mechanical point of view there is no difference between the manufacturing of military ammunition and commercial ammunition except that the same machinery will produce more military ammunition because there are fewer sizes and types of the former than the latter. The war business came to the manufacturer. There was no selling to be done. Price was relatively no object. Production was of a few types in large volume, which made costs much lower. In case of the commercial ammunition produced in the pre-war and post-war periods there were a large number of kinds of articles for all varieties of arms, the demand for which was governed by the whim of the public who shot one load one year and another load another year. Competition was severe and keen. The industry was believed to be declining and the only way to get new business was to take it away from competitors.

53. The value of the plaintiff's right to use the buildings erected by it on the land of the Wamesit Power Company as aforesaid for the six years of its lease remaining after December 31, 1918, did not exceed $190,969.86.

54. The fair annual value of the plaintiff's right to use the buildings erected by the plaintiff on the land of the Wamesit Power Company as aforesaid (including the garage) during the six years following December 31, 1918, on the terms under which the plaintiff held such buildings, was $31,126.48 and the value of such right for said six years was $186,758.88.

55. The fair annual value of the plaintiff's right to use the garage erected by the plaintiff on land of the Wamesit Power Company for the six years following December 31, 1918, on the terms under which the plaintiff held such buildings was $2,525.60 and the value of such right for said

six years was $15,153.60.

[fol. 75] 56. The plaintiff had erected the garage for storage and service of its own trucks and automobiles used in its war business. It had no need for the garage before or after its war business. From 1919 to October, 1923, the building was operated as a public garage through a subsidiary company. An agency for the sale of certain automobiles was also conducted. It was used in its entirety for these purposes. This garage business showed a loss and the plaintiff realized no net return from the garage until October, 1923, when it was leased to others at a rental of $300 a month, the plaintiff paying the taxes and insurance on the building. A fair allowance for taxes, insurance, and necessary repairs would be at least 5 cents per square foot annually, or $1,148 a year. The net return from such rental of the garage was at the rate of between 10 cents and 11 cents a square foot annually.

57. Under date of November 15, 1922, the plaintiff, in response to an inquiry from the Bureau of Internal Revenue, furnished schedules which had been prepared by certified accountants showing as nearly as could be ascertained from the company's records the number of square feet of floor space allotted to the various departments of the plaintiff's business during the periods between January 1, 1919, and November, 1922. The figures contained in the said schedules were based on the company's records, and not on actual measurement taken at that time, and, although they are inexact in some particulars, they show with substantial accuracy the proportionate part of space allotted to various departments and the proportionate part of idle and vacant space not allotted to operating departments in plaintiff's leasehold and annual rental buildings. In the said schedules the buildings erected by the plaintiff at Lowell and South Lowell, Massachusetts, and occupied rent-free, are referred to as leasehold buildings as distinguished from the buildings at Lowell, Massachusetts, which the plaintiff did not construct and which were occupied on an annual-rental basis. In October, 1922, or thereabouts, a complete rearrangement and reallocation of space for the plaintiff's various activities was made in the leasehold and annual-rental buildings. The schedules furnished the Bureau of Internal Revenue by the plaintiff on Novem-

stated in Finding 33 at the date and in the amounts shown below:

	Unworked direct material	Worked direct material
P6489–1489Sa and supplement:		
Jan. 30, 1920	$426,864.61	
July 28, 1920	4,875.07	$80,189.85
P12289-3034A: Sept. 20, 1920	23,581.72	37,978.72
GA-126: June 11, Sept. 20, 1920	3,699.59	1,504.32
P12621-3124A: Sept., 1920	6,377.33	9,489.13
	465,398.32	129,162.02
	.....	465,398.32
	.....	129,162.02
Total payment in 1920 for direct worked and unworked material	.....	594,560.34

33. The amounts as stated in Finding 32 did not include anything for cost of labor and overhead expense incurred by the plaintiff in working the worked material but included the cost of the raw material in such worked material. There were many unsettled differences between the parties at the time as to the amounts to be allowed for such labor and expense. Such differences continued until the final settlements under the respective contracts and the plaintiff was not paid anything for such labor and expense until the final settlements. In addition to the direct materials and work in process taken over and paid for as stated above there were other similar items for which the plaintiff claimed reimbursement but which the defendant did not at the time accept or pay for. In the final settlements made in 1921 and 1922 the defendant agreed to pay for certain of these items. The defendant declined in said settlements to take over and to pay for a part of such material and work in process on hand on December 31, 1918, or to reimburse the plaintiff for any loss on account of such part, basing such refusal on various grounds, including the ground that the amount on hand exceeded the amount required to perform the contracts under consideration.

34. Under contract P6489-1489 Sa there was a controversy between the parties as to whether any allowance should be made to the plaintiff for useful component parts contained in certain cartridges which had been rejected because of defective primers, but which could be reworked and made into acceptable cartridges. The plaintiff had a quantity of these rejected cartridges on hand at Decem-

ber 31, 1918, for which the plaintiff claimed from the Gov-
[fol. 68] ernment about $58,000 based on the cost to the plaintiff of the reclaimable component parts in these rejected cartridges. During the war the Government accepted such reworked cartridges and paid the full contract price therefor. The War Department declined to take over this material in 1920, when the greater part of the material under contract P6489-1489 Sa was taken over by the Government. In the final settlement of said contract in December, 1921, the plaintiff's claim for this item was compromised and the Government allowed $28,915.44 for the reclaimable component parts in these rejected cartridges and the plaintiff retained the cartridges. These cartridges were later sold for their scrap value, which was much less than the balance of the plaintiff's claim.

35. The preparation and presentation of the plaintiff's claims under its various war contracts with the defendant in accordance with the requirements of the War Department and the Government audit of those claims required a large amount of work extending over several years. The plaintiff had claims against the defendant under contracts other than those enumerated above. One of the contracts under which the plaintiff had such claims, known as 14066, was a cost-plus contract and was several times as large as the contracts involved in the present case taken together. Certain costs had to be apportioned between contract 14066 and the other business of the plaintiff. At times the plaintiff employed 35 or 40 persons in its department of accounts and settlements. The plaintiff spent approximately $400,000 (exclusive of legal expenses) in meeting the requirements of the War Department as to the proof of its claims under its various contracts including, among others, contract 14066 and the contracts involved in the present case. The defendant had a staff of accountants at the plaintiff's plant at Lowell, Massachusetts, which had been there during the war and remained until about July, 1921, when it moved to Watertown, Massachusetts. These accountants were working on the plaintiff's claims as late as August, 1922.

36. Before the plaintiff had reached a final settlement of any of the contracts it received various letters from Government agencies relating to the necessity of having its claims settled by specific dates. About July 29, 1919, the

62. Of the buildings which plaintiff occupied on an annual rental basis, 96,494 square feet of a total area of 139,334 square feet were incorporated into certain leasehold buildings at Lowell, Massachusetts, so that such combined leasehold and annual rental buildings had to be used as a unit unless the plant was revamped. The area of the leasehold buildings at Lowell so incorporated was 147,064 square feet of a total area of leasehold buildings at Lowell of 179,920 square feet. Of the annual rental buildings so incorporated 47,816 square feet were of brick construction and 48,678 square feet were of wood construction; and of the leasehold buildings so incorporated, 139,293 square feet were of brick construction and 7,771 square feet were of wood construction.

63. In the latter part of 1921 plaintiff terminated the rental of 38,469 square feet of annual rental space at Lowell, Massachusetts. There were no company constructed leasehold buildings incorporated with such annual rental buildings. The leasehold buildings at South Lowell constituted a separate and distinct plant containing no annual rental buildings. During the war the leasehold buildings at South Lowell were used for the manufacture of munitions.

64. The types of construction of plaintiff's leasehold and annual rental buildings and relative percentage of each type of construction are as follows:

	Concrete	Brick	Frame
Leasehold buildings:			
Lowell	15%	78%	7%
South Lowell	....	62%	38%
Annual rental buildings	15%	39%	46%

[fol. 78] 65. The plaintiff never ceased in its efforts to increase its sales of commercial ammunition. The amount of the plaintiff's commercial ammunition business from 1913 to 1924 is shown by the following statistics, the figures representing cartridges produced and blank spaces indicating no record of production for such period:

Year	Kind of ammunition			
	Shot shell	Rim fire	C. f. pistol	C. f. military
1913	.....	77,192,000	11,867,000	.....
1914	48,691,570	117,719,000	14,659,000	.....
1915	64,590,136	123,850,000	.....	.....
1916	70,758,703	114,237,000	23,807,000	3,105,000
1917	49,549,564	.....	.....	.....
1918	64,725,560	62,428,000	86,143,000	173,500
1919	92,083,535	132,392,000	31,461,000	2,628,000
1920	69,720,786	170,943,190	36,973,150	3,253,931
1921	66,671,323	64,641,731	10,206,751	1,188,951
1922	71,798,727	136,338,825	16,881,000	1,993,760
1923	78,594,800	178,875,600	17,425,459	1,952,030
1924	59,825,699	275,424,900	19,863,150	1,961,200

66. At the end of 1918 all of the space in plaintiff's leasehold buildings at Lowell and South Lowell, Mass., was being utilized either for manufacturing or storage purposes.

67. The premises rented by the plaintiff from the Wamesit Power Company for the years 1914 to 1924 (excluding the land on which the new buildings were constructed) were not held under any written lease, but the plaintiff was a tenant at will throughout the period. The number of square feet of floor space on January 1st of each year in the rented buildings (as distinguished from the leasehold buildings constructed by the plaintiff) and the annual rental for the same were as follows:

Year	Floor area of bldgs. on January 1	Annual rental	Rental per square foot
1914	89,074 sq. ft.	$9,560.00	$0.1073
1915	65,674 " "	12,000.00	.1827
1916	97,804 " "	15,766.00	.1612
1917	139,334 " "	20,188.00	.1448
1918	139,334 " "	20,188.00	.1448
1919	139,334 " "	20,188.00	.1448
1920	139,334 " "	20,188.00	.1448
1921	139,334 " "	20,188.00	.1448
1922	102,709 " "	17,488.00	.1702
1923	102,709 " "	17,488.00	.1702
1924	101,209 " "	17,188.00	.1698
Average, 1914-1924	.....	.....	.1516

The landlord paid the taxes and insurance on these buildings. The premises rented included not only buildings of the area which had been stated but the right to use the railroad sidetrack on the premises, the use of water from the Wamesit Canal for industrial purposes, and also the right to use certain land not covered by buildings.

[fol. 79] 68. The comparative sales of ammunition and subsidiary products manufactured by plaintiff from the years 1920 to 1924 were as follows:

	1920	1921	1922
Ammunition	$3,611,478.13	$2,006,237.21	$2,747,696.68
Radiator tubes & cores	113,546.39	139,810.27	207,545.37
Motors	65,760.42	52,018.38	94,689.77
Paper boxes	54,749.06	55,165.20	28,489.31
Totals	[1] 3,845,534.00	2,253,231.06	3,078,421.13

	1923	1924
Ammunition	$2,853,460.81	$2,728,890.14
Radiator tubes & cores	269,099.22	228,156.26
Motors	78,389.71	61,948.72
Paper boxes	.....	.....
Totals	3,200,949.74	3,018,995.12

[1] Figures for 1920 are gross from which discounts and allowances of $183,085.72 should be deducted. For remaining years figures are net value.

The manufacture of radiators started late in 1917. The manufacture of paper boxes started in February, 1920, and ceased as of October 7, 1922. The manufacture of motors started early in 1920 and was discontinued January 1, 1925.

Conclusion of Law

Upon the foregoing special findings of fact, which are made part of the judgment herein, the court decides as a conclusion of law that the plaintiff is entitled to recover under the Italian contract, and judgment will be awarded for the amount to which it is entitled when a stipulation of the parties has been filed showing the amount due in accordance with the opinion. As to the other items of the claim, the petition is dismissed.

Opinion

Booth, Chief Justice, delivered the opinion of the court:

This case presents the determination, under the revenue laws and regulations of the Commissioner of Internal Revenue, of plaintiff's tax liability for the year 1918.

The plaintiff is a Massachusetts corporation and during the late World War was engaged in the manufacture of ammunition to be used both in this country and abroad. In making its tax return for the calendar year 1918 two contentions arose as to the proper valuation of its inventory

for the year and the denial by the commissioner of a deduction from gross income for the year of the cost of buildings erected upon leased grounds.

No jurisdictional question arises and the case depends solely upon the issues stated. The facts which follow must be stated in detail.

The plaintiff's books of account were kept upon an accrual basis. On March 19, 1917, the Maxim Munitions Corporation, a Delaware corporation, entered into a contract with the Officine di Villar Perosa, an Italian corporation acting for the Italian Government, hereafter referred to as the Italian contract, for the manufacture and delivery of 250,000,000 nine-millimeter cartridges. This contract was amended May 31, 1917, and December 14, 1917, the last amendment reducing the quantity of ammunition to be delivered to 125,000,000 cartridges. All of this ammunition was of special design and intended for use by Italy in the war. The Maxim Corporation was required to give bond for the faithful performance of the contract and re- [fol. 80] ceived from Italy an advanced payment of $1,531,250 for the ammunition to be delivered under the contract. In order to procure the exacted bond the Maxim Corporation deposited with the Maryland Casualty Company, the Fidelity and Deposit Company of Maryland, and the United States Fidelity and Guaranty Company of the same State, the entire sum so advanced, in such proportions as to secure each of the companies against loss, and later on, when the quantity of cartridges to be delivered was reduced one-half, the surety companies reduced their collateral one-half, and this amount was returned to the Italian corporation and retained by it.

On October 5, 1917, the plaintiff entered into a written contract with the Maxim Corporation by the terms of which the plaintiff agreed to manufacture and deliver the ammunition in the quantities stipulated and in accord with the terms of the existing contract between the Maxim Corportation and the Italian Government. In other words, the plaintiff took over the Maxim contract. The plaintiff acquired materials, manufactured and delivered a large quantity of cartridges, and had on hand materials and undelivered cartridges involved herein, when on November 22, 1918, the Italian authorities canceled the contract of March

19, 1917, between the Maxim Corporation and Italy, and thereafter declined to accept any additional deliveries whatever. Some dispute arose as to the authority of those acting to cancel, an unessential point, but the plaintiff company accepted cancellation as accomplished, and on November 26, 1918, discontinued the manufacture of cartridges entirely. It is conceded by the parties that at the time of the cancellation of the Maxim contract the unworked and finished materials then on hand in plaintiff's plant applicable to the Maxim contract possessed a market value of $79,297.11 and a cost value of $274,659.78. (See Finding 20.) The plaintiff did not realize the cost value of the materials. Following the cancellation of the Maxim contract negotiations ensued for a settlement with the Italian Government for the loss occasioned thereby, but neither the plaintiff nor the Maxim Corporation ever obtained any sums in addition to the advance payment made to the Maxim Corporation as heretofore noted. In virtue of waivers filed by the plaintiff its tax liability, due to audits and examination of its books of account in relation to this particular contract and other transactions to follow, was not finally determined until January 16, 1926, when the commissioner declined to allow the plaintiff to value its inventory for the year at the market value of the materials on hand to perform its contract with the Maxim Corporation, i. e., $79,297.11, and instead valued its inventory at cost, i. e., $274,659.78.

During the calendar year 1918 the Maxim Munitions Corporation was insolvent, it could not have possibly performed its Italian contract nor pay the plaintiff for its unworked material and finished munitions. It was indebted to the plaintiff in the sum of $300,000, and doubtless because of its insolvency and indebtedness to the plaintiff the contract involved herein was made. On May 29, 1919, a petition of involuntary bankruptcy was filed against the Maxim Corporation and on June 18, 1919, it was adjudicated a bankrupt.

Sec. 203 of the Revenue Act of 1918 (40 Stat. 1057, 1060) provides as follows:

[fol. 81] "That whenever in the opinion of the commissioner the use of inventories is necessary in order clearly to determine the income of any taxpayer, inventories shall be taken by such taxpayer upon such basis as the commis-

sioner, with the approval of the Secretary, may prescribe as conforming as nearly as may be to the best accounting practice in the trade or business and as most clearly reflecting the income."

Sec. 234 of the Revenue Act of 1918 (40 Stat. 1077) provides in part as follows:

"Sec. 234 (a). That in computing the net income of a corporation subject to the tax imposed by section 230 there shall be allowed as deductions:

* * * * * * *

"(4) Losses sustained during the taxable year and not compensated for by insurance or otherwise; * * *."

Art. 1584 of Regulations 45, the first regulations promulgated under the act of 1918, reads as follows:

"Art. 1584. Inventories at Market.—Under ordinary circumstances 'market' means the current bid price prevailing at the date of the inventory for the particular merchandise in the volume in which ordinarily purchased by the taxpayer and is applicable in the cases (a) of goods purchased and on hand, and (b) of basic elements of cost (materials, labor, and burden) in goods in process of manufacture and in finished goods on hand; exclusive, however, of goods on hand or in process of manufacture for delivery upon firm sales contracts at fixed prices entered into before the date of the inventory, * * *."

Articles 1612 and 1614 of Regulations 65, in force in 1926 when the additional taxes now complained of were assessed and paid, read as follows:

"Art. 1612. Valuation of Inventories.—The act provides two tests to which each inventory must conform: (1) It must conform as nearly as may be to the best accounting practice in the trade or business, and (2) it must clearly reflect the income * * *. An inventory that can be used under the best accounting practice in a balance sheet showing the financial position of the taxpayer can, as a general rule, be regarded as clearly reflecting his income.

"The basis of valuation most commonly used by business concerns and which meets the requirements of the

revenue act is (a) cost or (b) cost or market, whichever is lower. (For inventories by dealers in securities, see article 1615.) Any goods in an inventory which are unsalable at normal prices or unusable in the normal way because of damage, imperfections, shop wear, changes of style, odd or broken lots, or other similar causes, including second-hand goods taken in exchange, should be valued at bona fide selling prices less cost of selling whether basis (a) or (b) is used, or if such goods consist of raw materials or partly finished goods held for use or consumption, they shall be valued upon a reasonable basis, taking into consideration the usability and the condition of the goods, but in no case shall such value be less than the scrap value. * * *

"Art. 1614. Inventories at Market.—Under ordinary circumstances, and for normal goods in an inventory, 'market' means the current bid price prevailing at the date of [fol. 82] inventory for the particular merchandise in the volume in which usually purchased by the taxpayer, and is applicable in the cases (a) of goods purchased and on hand, and (b) of basic elements of cost (materials, labor, and burden) in goods in process of manufacture and in finished goods on hand; exclusive, however, of goods on hand or in process of manufacture for delivery upon firm sales contracts (i. e., those not legally subject to cancellation by either party) at fixed prices entered into before the date of the inventory, which goods must be inventoried at cost * * *."

The plaintiff insists that it was entitled under the regulations to value its inventory at cost or market, whichever was lower. The defendant contends that a lawful exception prevails as to this option granted by the regulations in the case "of goods on hand or in process of manufacture for delivery upon firm sales contracts (i. e., those not legally subject to cancellation by either party) at fixed prices entered into before the date of inventory, which goods must be inventoried at cost." The purpose of inventories in a business enterprise such as we have here is apparent and the commissioner's regulations as to a valuation of the same on the basis of cost or market value, whichever is lower, were clearly to ascertain accurately annual income

in view of fluctuating values of merchandise on hand, at the beginning and close of the year. Mutual Chemical Company of America, 12 B. T. A. 578. If, however, the taxpayer possesses a contract stipulating a fixed price for the commodity to be manufactured he is, as pointed out in the opinion just cited, "protected against any reduction in value occasioned by declining market prices." The single exception to the above rule is applicable only to contracts to manufacture and deliver a completed article subject to cancellation by either party. Of course, if a taxpayer is protected against loss of value of unworked materials by the terms of a fixed contract of sale, and obviously such would be the case in firm sales contracts, the valuation of his inventories as related to the contract is not dependable upon cost or market, whichever is lower, and actual income is not to be ascertained by according to inventories the procedure set forth in the regulations where no such condition obtains.

The intent of the regulations, aside from the language used, is manifestly to apply them as the actual situation presents itself to the commissioner. When the plaintiff's tax liability was finally determined by the commissioner it was known to him that the contract between plaintiff and the Maxim Munitions Corporation had been canceled before the expiration of the year 1918. It was also known to him that the Maxim Corporation was insolvent and had been adjudicated a bankrupt, and that plaintiff had not been able to realize cost or anyway near cost for the materials procured by it to perform the Maxim contract. The record further discloses that knowledge of the Italian Government's disavowal of any liability under the Maxim contract was brought to his attention, and that hope or prospect of realizing contract prices for munitions under the Italian contract had been foreclosed. The contract between the plaintiff and the Maxim Munitions Corporation contained no cancellation clause applicable to the present contention, but the contract between the Maxim Munitions Corporation and the Italian Corporation, which is the essential subject matter from which source the plaintiff's income for the term involved was to accrue, did contain a stipulation as follows:

[fol. 83] "Ninth Performance.—In the event that the seller shall fail to make deliveries within sixty (60) days after the date or dates upon which such deliveries are due according to the terms of this contract, by reason of fires, strikes, wrecks, explosions, confiscations, eminent domain, the acts of God or the public enemy or for any reason whatsoever, the buyer shall have the right to cancel this contract."

Under this clause of the Italian contract the right of cancellation was exercised and liability to the contractor for losses occasioned thereby expressly disavowed by the Italian corporation.

Beyond doubt, default in deliveries obtained. What the plaintiff secured by its contract with the Maxim Munitions Corporation was the right to perform the latter's contract with the Italian corporation—the right, as expressly stated in the contract, "to manufacture cartridges upon the said contracts herein mentioned"—and the contracts identified by "herein mentioned" were the Italian contracts. The situation in which the plaintiff found itself in 1918 was not one where it was in process of performing a firm sales contract; the contract had been suspended, the plaintiff's performance had been effectually foreclosed, and no reason existed to expect that any of the articles contracted for would ever be delivered the owner of the contract known to be insolvent and no hope of realizing the contract price for delivered articles obtained. If, therefore, the intent of the regulation is to predicate the ascertainment of income, in cases involving a firm sales contract, upon the fact that a valid contract exists whereby the contractor will in due course obtain the contract price, and that the inventory of materials on hand to perform the contract is by reason thereof worth more as a current asset than their market value, then, in so far as the Maxim contract with the plaintiff is concerned, the plaintiff is entitled to value its inventory at market value. It is true that in 1917 the sureties on the bond of the Maxim Munitions Corporation at the request of the corporation loaned the plaintiff $612,500 from the sum deposited with them, i. e., the advance payment made by the Italian Government to the corporation which it deposited with the surety companies to go on its bond. This

loan made under contracts for repayment, details of which we need not discuss, was in addition secured by the plaintiff's notes for the amount loaned, guaranteed by the National Lead Company (Finding 11). The plaintiff has not paid the notes, and suits are now pending against it for their payment and as yet undetermined. The plaintiff on its books of account carries as a liability upon the notes a sufficient reserve to liquidate a possible judgment against it because of this litigation. The defendant asserts that the plaintiff has this sum of money, that it is in excess of the $300,000 which the Maxim Munitions Corporation owes the plaintiff, and also in excess of the total of the former amount and the sum of $274,659.78 valuation put upon the plaintiff's inventory by the commissioner in 1926, and that in the event of the plaintiff's successful defense to the pending suits to recover the amount of the loan, the plaintiff will recover more than the contract value of the materials left on its hands by the cancellation of the Maxim contract with Italy. It is also true that the plaintiff purchased on March 16, 1926, for a consideration of $61,250 an unconditional conveyance from the trustees in bankruptcy of the Maxim Munitions Corporation, all the in- [fol. 84] terest of said corporation in and all rights of action it might have against the Italian corporation, and attempts were made to realize from the Italian corporation the loss plaintiff suffered by reason of the cancellation of the Maxim Munitions Corporation contract.

From these facts the defendant argues that the plaintiff has a valid claim for reimbursement of the cost of its inventory. The plaintiff's only possible recourse against the Italian corporation must originate in the purchase of the interests of the Maxim Munitions Corporation against the Italian Government. The record discloses that attempts to procure a settlement with the Italian corporation failed, and that the corporation is possessed of no assets in the United States and no known place of conducting business here, where service could be had upon it. In addition to the inferences which may be drawn from the facts as recited, the transactions cited are but remotely related to the issue of the valuation of inventories. Borrowed funds and assigned rights of action under a contract are not directly related to the valuation of inventories; they of course con-

ber 15, 1922, were accompanied by a letter signed by W. R. B. Whittier, treasurer of the company, addressed to William F. R. Griffith, an appraisal engineer then employed in the Bureau of Internal Revenue.

Analysis of use of plaintiff's leasehold and annual rental buildings at Lowell and South Lowell, Massachusetts, and schedules showing type of construction of buildings, the said plants, floor area of each building and total square feet of idle or vacant space in each building at the beginning of each of the years 1919 to 1922, inclusive, and at October, 1922, prepared from the said schedules furnished by the plaintiff on November 15, 1922, are annexed to the additional agreed statements of facts filed on July 5, 1929, marked "Exhibits 20 to 24," and are made a part hereof by reference.

[fol. 76] 58. At the periods stated below, the kinds of use and the percentage of space allotted to each kind of use in plaintiff's leasehold buildings at Lowell and South Lowell, Massachusetts (upon which the plaintiff claims loss of useful value), were as follows:

Kind of use	Percentage of use				New layout, Oct. 1922
	Jan. 1919	Jan. 1920	Jan. 1921	Jan. 1922	
Machine occupied space:					
Ammunition manufacture	15%	26%	38%	38%	28%
Radiator, motor, and paper-box manufacture, and wasting, annealing and hardening	1%	4%	11%	13%	7%
Total machine occupied space	16%	30%	49%	51%	35%
Service departments	23%	25%	24%	24%	12%
Total manufacturing space (machine occupied and service departments)	39%	55%	73%	75%	47%
Extraneous use of space	21%	24%	21%	21%	27%
Total company use of space	60%	79%	94%	96%	74%
Government storage (machinery and materials)	28%	11%	.....	.....	.....
Total use of buildings	88%	90%	94%	96%	74%
Idle and vacant space	12%	10%	6%	4%	26%
Total available space	100%	100%	100%	100%	100%

Not all the space allotted to the various departments was actually used.

59. At the periods stated below, the kinds of use and the percentage of space allotted to each kind of use in plaintiff's annual rental buildings at Lowell, Massachusetts, were as follows:

Kind of use	Percentage of use				New layout,
	Jan. 1919	Jan. 1920	Jan. 1921	Jan. 1922	Oct., 1922
Machine occupied space:					
Ammunition manufacture	34%	16%	18%	26%	20%
Radiator, motor, and safety-razor manufacture	.....	11%	23%	9%	4%
Total machine occupied space	34%	27%	41%	35%	24%
Service departments	19%	27%	38%	42%	46%
Total manufacturing space (machine occupied and service departments)	53%	54%	79%	77%	70%
Extraneous use of space	13%	19%	15%	5%	11%
Total company use of space	66%	73%	94%	82%	81%
Government storage	25%	5%	.....	.....	.....
Total use of buildings	91%	78%	94%	82%	81%
Idle and vacant space	9%	22%	6%	18%	19%
Total available space	100%	100%	100%	100%	100%

Not all the space allotted to the various departments was actually used.

[fol. 77] 60. At the periods stated below the percentage of space allotted directly to machinery for ammunition manufacture in plaintiff's leasehold buildings to the total space allotted for such purpose in all buildings (leasehold and annual rental buildings) was as follows:

Jan., 1919	Jan., 1920	Jan., 1921	Jan., 1922	New layout, Oct., 1922
48%	77%	81%	81%	80%

61. At the periods stated below the percentage of space allotted directly to the machinery for all types of manufacture in plaintiff's leasehold buildings to the total space allotted for such purpose in all buildings (leasehold and annual rental buildings) was as follows:

Jan., 1919	Jan., 1920	Jan., 1921	Jan., 1922	New layout, Oct., 1922
49%	70%	71%	81%	80%

stitute a factor in the ascertainment of income, but their bearing upon the issue in suit is too remote and too conjectural to influence the question of what valuation should be placed under the law and regulations upon the unused and unworked materials allocated to contract work after the contract has been canceled, especially so when the known facts discredit the possibility of realizing from the sources alleged, and a period of eight years having elapsed without any benefical results. It is impossible now to indicate what may be the outcome of the litigation pending, and whatever it may be the taxing laws take care of it when it becomes a certainty. Lewellyn v. Electric Reduction Co., 275 U. S. 243.

United States Contracts

The plaintiff entered into four contracts with the United States, represented by the War Department. One of the contracts provided for the manufacture and delivery of 135,100,000 .45-caliber cartridges, and the other three for the manufacture and delivery of 14,760,000 artillery primers. One of the contracts was made in 1917 and all the others on various dates in 1918 prior to November 11, 1918. In each of the contracts there was a provision for their cancellation in the event of the termination of the war, and likewise a provision for settlement of and payment to the plaintiff of amounts due it by reason of cancellation. As to materials on hand at time of cancellation the contracts provided as follows:

"* * * The United States shall also pay to the contractor the cost of the materials and component parts purchased by the contractor for the performance of this contract and then on hand in an amount not exceeding the requirements for the completion of this contract, provided they comply with the specifications, and also all costs shown by the contractor to have been theretofore necessarily incurred in the performance of this contract and remaining unpaid; and the United States shall also protect the contractor on all obligations incurred necessarily and solely for the performance of this contract of which the contractor cannot be otherwise relieved. To the above may be added such sums as the Chief of Ordnance may deem necessary to

[fol. 85] fairly and justly compensate the contractor for work, labor, and service rendered under this contract.

"Title to all such materials and component parts paid for by the United States under this article shall, immediately upon such payment, vest in the United States. * * *"

In December, 1918, following the armistice, the contracts were suspended and the plaintiff duly notified. The plaintiff observed the suspension notice and thereafter, in virtue of settlement contracts, following a somewhat prolonged inspection and audit of plaintiff's accounts, a final settlement was concluded by the terms of which the plaintiff was paid the total sum of $1,154,618.35. Included in the sum so paid is an item of the cost of materials and finished and unfinished articles in plaintiff's plant allocated to the contracts involved, the conceded value of which was $732,088.62. In placing a valuation upon its inventory for the year 1918 the plaintiff claims it is entitled to fix the sum at the market value of the materials, etc., on hand to fulfill the contracts, i. e., the conceded market value of $231,615.43.

The Commissioner of Internal Revenue declined to accede to plaintiff's claim, and instead assessed, levied and collected from plaintiff income, excess profits, and war-profits taxes by valuing plaintiff's inventory for the year 1918 on the basis of the sum paid to it by the United States for materials allocated to the contracts, i. e., $732,088.62. Plaintiff's argument is addressed mostly to the same regulations and sections of the revenue laws that are involved in its contention with reference to inventory values in the preceding Italian contract. The facts as to the United States contracts present a decidedly different situation than was involved in the Italian contract. The United States contracts clearly disclose "firm sales contracts at fixed prices" and while the contracts were subject to cancellation, they contained express covenants upon the part of the United States to save the plaintiff harmless in so far as the cost of materials, etc., entering into its inventory is concerned. The contracts contained express provisions setting forth with exactness how the plaintiff should be paid, and the items included within the Government's liability

to pay. The regulations of the commissioner, heretofore cited, article 1612 of regulations 65, wherein appears an option to value inventories at cost or market, whichever is lower, must, as we have previously said, be construed in the light of their purpose and in view of an actual and subsisting situation. There can be no doubt that if the plaintiff's contention is correct, the value it seeks to place upon its inventory for the year 1918 does not represent the actual value received by it for the materials mentioned and does not clearly reflect its income for the year involved.

The commissioner in determining the plaintiff's tax liability for 1918 had before him the actual situation with respect to plaintiff's status in relation to the United States contracts, and upon the basis of the same determined the tax. The plaintiff does not challenge the correctness of the amounts or dispute the receipt of the sums involved, which necessarily leaves its contention upon the single insistence that the words of the regulations entitle it to recover. Inventories at the beginning and end of the year, as provided for in the regulations, are essential to ascertain income, and if their valuation may be fixed upon a basis known to be contrary to the actual facts, the purpose of [fol. 86] the same is in no sense accomplished. All through the regulations concerned with this subject matter run numerous provisions designed to meet situations wherein inventories are to be used, which clearly reflect an intent to value the inventories so used upon a basis of fact, and assuredly such a basis may not be challenged as counter to good accounting practice. It is of course true that at the close of the year 1918 the plaintiff was unaware as to the precise sum it would receive in dollars and cents for the materials on hand, the ascertainment of the same was yet to be made and the final result dependent upon accounting. It did, however, possess an enforceable demand for their cost in the form of a positive covenant to pay the same from a responsible party, and having voluntarily waived its right to have its tax liability for the year 1918 determined within the period of the statute of limitations with respect thereto, thereby enabled the exact determination of the cost of its inventory free from any uncertainty. The fixed statutory period within which the commissioner must determine a taxpayer's liability is a period which Congress

extended to him to ascertain liability, and the ascertainment of the same is to be accomplished from the taxpayer's return.

We need not recite the details essential to be pursued. It is in this case sufficient to state that an audit of plaintiff's return was available to the commissioner and actual facts developed from such an audit may not be ignored. Therefore, it seems evident to the court that so long as the commissioner was lawfully possessed of the right to determine plaintiff's tax liability for the year 1918, and unquestionably the subject matter was within his jurisdiction when he did act, he had under the law and regulations the right to take into consideration the fiscal transactions of the plaintiff occurring in that year and the final consummation of the same notwithstanding it required additional time to ascertain the facts all taking place within the statutory period.

The plaintiff kept it books upon an accrual basis, and when it made its tax returns neither it nor the commissioner could determine with accuracy its tax liability for the year 1918. The time consumed by both parties was in an effort to fix its taxes for 1918 upon the basis of what the actual value of its inventory should be, and before the statute of limitations expired facts developed which did fix the value of the same in dollars and cents. In this respect the case is no different from the adopted procedure many times occurring with respect to all tax returns involving a similar situation, and to hold that the commissioner was bound as to the valuation of the inventory given by the taxpayer in the return filed for 1918, when later facts clearly and indisputably show that for all the items involved the taxpayer received cost of the same, would require the court to negative a positive fact. Keeping in mind that action of the commissioner challenged in this case relates exclusively to plaintiff's tax liability for 1918, and that the commissioner was acting within the scope of his jurisdiction, we find nothing in the many regulations cited to warrant a contrary holding.

The claims, i. e., the rights conferred upon the plaintiff under the settlement contracts executed by the parties within the year 1918, brought about a situation which within the statutory period matured into an observance of [fol. 87] the settlement contracts by the United States and

the plaintiff received payment in accord therewith, and all this was part of and essential to the ascertainment of plaintiff's inventory value for the year 1918. An entirely different situation might have developed, a matter not within the purview of the issue in this case, if the settlements had not been accomplished within the statutory period, and payments for the inventory had been postponed to later years. But in such case it would have been the duty of the commissioner to determine the inventory at the actual cost to the plaintiff. The plaintiff executed the settlement contracts, proceeded thereunder and received without protest within the statutory period determining its tax liability for 1918 the cost value of its inventory for that year, and while the payment was not made in 1918 it was made to pay for the cost of materials, etc., included in plaintiff's inventory for 1918. In the case of Producers Fuel Co., 1 B. T. A. 202, the Board of Tax Appeals determined a controversy involving the principle upon which we rely. The Producers Fuel Company in December, 1920, deliberately breached a contract for the future delivery to it of coal and set up on its books for the year 1920 an estimated liability upon the contract breached. Thereafter in 1921 the company compromised with its contractors for the breach and paid the sum of $35,292.40 in cash. The reserve set up on its books as before noted totaled $37,500, and the company claimed as a deduction this estimated amount from its gross income for the year 1920. The Board of Tax Appeals decided adversely to the plaintiff's contention, and in so doing said—

"While it appears that at the end of the year 1920, this taxpayer estimated its liability under the breached contracts with approximate accuracy and set the sum up on its books of account and then made its income and profits tax return in accordance with such books, we have now before us a review of that income and profits tax return and in making such review it is our duty to consider not only the facts known and recorded at the close of December, 1920, but also those same facts as modified by subsequent events. These subsequent events have developed the fact that the damages and losses sustained by the taxpayer on account of the breach of the Monongahela contract were settled for the sum of $5,500, and that the damages and losses sustained by the taxpayer on account of the breach of the Campbell contract were finally determined and

settled for the sum of $29,742.40. With these facts before us, and for the purpose of determining the final net taxable income of the taxpayer for the year 1920, the amounts of damages and losses as finally determined must now be substituted for the estimate originally made, and in place of the deductions claimed by the taxpayer in his return and disallowed by the commissioner the losses and damages as finally settled must be allowed as the deduction contemplated by the law."

See also cases of McCreery et al., 4 B. T. A. 967, and Ewing Thomas Converting Co. v. McCaughn, 43 Fed. (2d) 503.

Claimed Deduction from Gross Income on Account of the Cost of Buildings Erected on Leased Ground

Prior to 1914 the plaintiff's factory buildings were rented from the Wamesit Power Company, the business of the plaintiff being carried on at Lowell, Massachusetts, in [fol. 88] the rented buildings owned by the Wamesit Company at that place. In 1914, shortly after the World War began, the plaintiff received orders from European governments for ammunition, and in view of orders in hand and additional ones anticipated, the plaintiff began the erection of buildings essential to its manufacturing needs on land of the Wamesit Power Company at Lowell and South Lowell, Mass. The buildings involved were erected under an agreement between the plaintiff and the Wamesit Power Company that the expense of their construction should be borne by the plaintiff and occupied free of rental by it for a term of ten years, at the expiration of which time they were to become the property of the Wamesit Power Company. Under this agreement, which contained other provisions not material here, the plaintiff erected the buildings involved at a conceded cost of $802,499.49. During the war plaintiff's factory necessities were great and the new buildings erected on the leased grounds were occupied to their capacity. After the close of the war and the suspension of its contracts for ammunition, its business receded to normal conditions and of course not all of the extra floor space of the buildings involved was needed. The lease under which the buildings were erected did not

by its terms expire until the close of 1924, and for the six years remaining, i. e., from 1918 to 1924, the plaintiff occupied the buildings, continuing the manufacture of commercial ammunition and adding to this activity the manufacture of radiators, radiator tubes, phonograph motors, paper boxes, and certain other articles. The plaintiff in its tax return for 1916 charged off as a deduction a very large part of the cost of these buildings and machinery. The Commissioner of Internal Revenue declined to allow the deduction in full, holding that the cost of the plant should be charged off over the ten-year period of the lease, and that only a proportionate part could be charged off each year. The plaintiff acquiesced in the commissioner's ruling. Later, however, when the war terminated and in making its tax return for 1918 the plaintiff claimed as a deduction from its gross income the depreciated value of the buildings as of December 31, 1917, less their residual value, a total of $414,421.89, this sum being arrived at in the following manner, viz:

Depreciation allowed by the Commissioner for the years 1914 to 1917, inclusive		$197,107.74
Cost of buildings	$802,499.49	
Less depreciation	197,107.74	
Leaving a depreciated value as of 1918 of		605,391.75
From which a subtraction of residual value		190,969.86
Leaves		414,421.89

The commissioner adhered to his former ruling, disallowed the claimed deductions, and instead allowed a depreciation deduction of $86,484.54, a proportionate annual allowance sufficient in amount to cover the cost of the buildings in the ten-year period of the lease.

The plaintiff's suit contests the ruling of the commissioner and contends for the deduction claimed in its return for 1918. If the plaintiff's contention is sound it is entitled to a substantial refund of taxes paid for the year 1918.

[fol. 89] Section 234 (a) of the Revenue Act of 1918 (40 Stat. 1077), in so far as here pertinent, provides as follows:

"Sec. 234 (a) That in computing the net income of a cor-

poration subject to the tax imposed by section 230 there shall be allowed as deductions * * *

"(4) Losses sustained during the taxable year and not compensated for by insurance or otherwise; * * *

"(7) A reasonable allowance for the exhaustion, wear and tear of property used in the trade or business, including a reasonable allowance for obsolescence; * * *"

Article 143 of Regulations 45 as to loss of useful value, is as follows:

"Art. 143. Loss of Useful Value.—When through some change in business conditions the usefulness in the business of some or all of the capital assets is suddenly terminated, so that the taxpayer discontinues the business or discards such assets permanently from use in the business, he may claim as a loss for the year in which he takes such action the difference between the cost or the fair market value as of March 1, 1913, of any asset so discarded (less any depreciation sustained) and its salvage value remaining. This exception to the rule requiring a sale or other disposition of property in order to establish a loss requires proof of some unforeseen cause by reason of which the property must be prematurely discarded, as, for example, where an increase in the cost of or other change in the manufacture of any product makes it necessary to abandon such manufacture, to which special machinery is exclusively devoted, or where new legislation directly or indirectly makes the continued profitable use of the property impossible. This exception does not extend to a case where the useful life of property terminates solely as a result of those gradual processes for which depreciation allowances are authorized. It does not apply to inventories or to other than capital assets. The exception applies to buildings only when they are permanently abandoned or permanently devoted to a radically different use, and to machinery only when its use as such is permanently abandoned. Any loss to be deductible under this exception must be charged off on the books and fully explained in returns of income. But see articles 181-189."

Article 109 of the same regulations, as to rentals, contains the following terms:

"Art. 109. Rentals.—Where a leasehold is acquired for business purposes for a specified sum, the purchaser may take as a deduction in his return an aliquot part of such sum each year, based on the number of years the lease has to run. Taxes paid by a tenant to or for a landlord for business property are additional rent and constitute a deductible item to the tenant and taxable income to the landlord, the amount of the tax being deductible by the latter. The cost borne by a lessee in erecting buildings or making permanent improvements on ground of which he is lessee is held to be a capital investment and not deductible as a business expense. In order to return to such taxpayer his investment of capital, an annual deduction may be made from gross income of an amount equal to the total cost of such improvements divided by the number of years remaining of the term of lease, and such deduction shall be in lieu of a deduction for depreciation. If the remainder of the [fol. 90] term of lease is greater than the probable life of the buildings erected, or of the improvement made, this deduction shall take the form of an allowance for depreciation. See article 48."

Additional applicable regulations are found in Articles 161 and 162 of Regulations 45, each of which we quote:

"Art. 161. Depreciation.—A reasonable allowance for the exhaustion, wear and tear, and obsolescence of property used in the trade or business may be deducted from gross income. For convenience such an allowance will usually be referred to as depreciation, excluding from the term any idea of a mere reduction in market value not resulting from exhaustion, wear and tear, or obsolescence. The proper allowance for such depreciation of any property used in the trade or business is that amount which should be set aside for the taxable year in accordance with a consistent plan by which the aggregate of such amounts for the useful life of the property in the business will suffice, with the salvage value, at the end of such useful life to provide in place of the property its cost, or its value as of March 1, 1913, if acquired by the taxpayer before that date. See further articles 839 and 844.

"Art. 162. Depreciable Property.—The necessity for a depreciation allowance arises from the fact that certain property used in the business gradually approaches a point

where its usefulness is exhausted. The allowance should be confined to property of this nature. In the case of tangible property, it applies to that which is subject to wear and tear, to decay or decline from natural causes, to exhaustion, and to obsolescence due to the normal progress of the art, as where machinery or other property must be replaced by a new invention, or due to the property becoming inadequate to the growing needs of the business. * * *"

The plaintiff asserts seven distinct reasons, predicated upon facts, relied upon to bring its contention within the revenue laws and the commissioner's regulations. The buildings, it is said, were constructed exclusively for war purposes, there existed no other use for them. The normal business of the plaintiff did not warrant their construction. They were erected on leased premises and their usefulness in any event limited to a ten-year period; they were used up to their capacity for war purposes until 1918. The plaintiff did not know and had no means of knowing when the war would terminate and hence it was impossible until that date to charge off more than their proportionate cost, as was done. Subsequent to the armistice the plaintiff did not contemplate the manufacture of war munitions for which the buildings had been erected; it received no new orders for war ammunition and of course was not to receive any. Income from rental of the buildings was not available because of a lack of demand for their use; they had been so incorporated into the buildings previously rented from the landlord that they had to be used as a unit unless at great cost they be revamped, which from a financial point of view was not warranted, and finally that the plaintiff sought, by adding to its commercial products the manufacture of a distinct line of articles not theretofore manufactured by it, to obtain a profitable use of the buildings, but without success. In other words, six years in advance of the complete obsoleteness under its lease of the buildings the plaintiff is to be allowed a deduction for the cost of the [fol. 91] same, upon the theory that they in 1918 became no longer useful for the precise purposes for which they were erected. It is true the plaintiff made the investment for the purpose of fulfilling war contracts for ammunition and that the armistice precluded a continuance of their use for this precise purpose, but the physical structures remained

upon the premises for at least the full term of its lease; they were used and occupied by the plaintiff during this period largely for the manufacture of ammunition for which use they were adapted; possession was not surrendered to the landlord or the buildings abandoned, and while unfortunately the continued business enterprise of the plaintiff proved unprofitable, it continued to go forward in these buildings under the same conditions applicable, as shown by the record, to pre-war times. What the plaintiff apparently complains of is not an injustice inflicted upon it by the commissioner in the amount of the annual or total sums allowed it as depreciation or obselescence allowances, but that a radical change in business relations and a serious diminution of income in 1918, entitled it to deduct from its gross income for 1918 the total balance of allowances which would accrue annually, less residual value of its lease in the year 1918. Obviously when the war was on, business abnormal and profits correspondingly so, manufacturers built according to their needs, and in many instances at the close of the war were in possession of quarters more than adequate for normal conditions. If however, as here, the buildings involved were upon leased premises continuously occupied by the tenant for the full term of the lease they thereby possessed a fixed period of value and usefulness. It is difficult to accurately determine in advance of the expiration of the lease any other loss to the lessee than the annual depreciation or obsolescence of the lease on any other than the basis of a final return of the capital investment. "Obsolescence," as said by the Board of Tax Appeals in the case of Tennessee Fibre Co., 15 B. T. A. 133, "as used in the statute is the state or process of becoming obsolete and the provision allowing a deduction therefor is intended to care for losses of capital which take place over a longer period than the taxable year." We are not confronted by the record with the happening of some event which rendered the buildings obsolete prior to the expiration of the lease, where the allowance of annual depreciation proportionate to their cost is insufficient to return cost of the same, for the buildings were not abandoned nor unsuitable for plaintiff's continued activities. Plaintiff may not have had use for all the floor space within them as it did previously, but this it not attributable to the buildings, it is due wholly to a loss of income from business activities.

The economic condition which affected plaintiff was almost wholly due to loss of volume of business and not its character. No single factor of the situation rendered the buildings obsolete in 1918, nor at any time thereafter until the expiration of the lease. Depreciation allowances under these circumstances comply with the revenue laws and regulation. In the recent case of Atwater & Co., Inc., 22 B. T. A. —, the opinion deals with an issue similar to the instant case. From the opinion we cite the following excerpts:

"The petitioner claims in the alternative that it is entitled to a deduction for the obsolescence of the discharging tower completed in February, 1919. This claim is made on the unique theory that obsolescence exists in a case [fol. 92] 'where the property turned out to be more than adequate for the needs of the business and it is foreseen that its value to the taxpayer is less than the balance of the cost less ordinary depreciation resulting from wear and tear spread over the actual physical life of the property.' * * *

"In the case at bar the element of obsolescence was not shown to have been present. We assume that the usual allowances were made for depreciation, wear and tear. No new or more modern machinery was being invented or used to replace its equipment. Only the ordinary repairs were necessary to insure its continued use as a modern and up-to-date facility such as would conform to the petitioner's present and future needs. Though the additional tower may have given petitioner an excess capacity, this fact does not establish obsolescence. We are of the opinion that petitioner is entitled to no deduction on the ground of obsolescence."

The Board of Tax Appeals in the case of Marigold Garden Co. v. Commissioner, 6 B. T. A. 368, 370, in discussing the principle involved in this case, said:

"Uselessness to a taxpayer does not determine a deductible loss any more when attributable to a statutory prohibition than when attributable to any other extraneous cause over which the owner has no control. A change in style or market or an exhaustion of the supply of raw materials for manufacture may destroy the utility of equipment just as effectually as the intervention of the law, and

the detriment to the owner may be just as great. It seems clear that property is not ipso facto lost to a taxpayer because it is no longer useful to him. Ownership and possession still exist, and in some cases value may not wholly disappear. Value and usefulness are not necessarily interdependent, even though they very commonly look to each other for support. The want of either does not make certain the absence of the other. It should be kept in mind that the considerations in ascertaining net income must always be expressed in money and that all the factors relied upon must be translated into terms of money. Use is only significant to the extent that it is susceptible of such expression. No one would urge that an income deduction may be claimed because a fixture or tool proves less useful than expected when the purchase was made. Until the investment is converted into terms of money by sale or other disposition or its worthlessness otherwise demonstrated, there is neither loss nor gain and income is neither greater nor less."

The case of the McCabe Lathe & Machinery Co., 9 B. T. A. 1137, 1143, decided in 1928, involved in part an issue similar to plaintiff's contention. In deciding the case the board in its opinion said:

"The mere fact that a building is used for a purpose different than that originally intended does not determine the building to be obsolete. The loss which will be sustained over the remainder of the lease, after allowing for exhaustion of the cost of the building, is deductible yearly and can not be anticipated upon the theory that obsolescence has taken place when, in fact, the building continues to be suitable for the purpose of its erection and all that has taken place is a reduction in its income-producing capacity. The determination of the commissioner as to this issue is, therefore, sustained."

See also Troy Mfg. Co. case, 7 B. T. A. 119; National City Bank of Seattle v. United States, 64 C. Cls. 236, 276 U. S. 620.

[fols. 93-95] We think a decided difference obtains between this case and the case of Burnet v. Niagara Falls Brewing Company, decided by the Supreme Court February 24, 1931, 282 U. S. —. The present record presents, in our opinion, a case where the plaintiff occupies buildings

upon leased premises, buildings which possess a useful life in excess of the life of the lease, but which in so far as the plaintiff is concerned become obsolete upon a date certain, and the commissioner possessed of this information determines obsolescence upon a basis which in accord with facts returns to the plaintiff the cost of the same. It is in all respects similar to a case wherein a business enterprise enjoying prosperity finds enlarged quarters essential to meet its demands, and without knowledge as to any exact date when an intervening incident may curtail its income, such as bad times, termination of a war, drought, etc., income is materially reduced or disappears, and the enlarged quarters are no longer essential for the needs of the corporation during this period of distress. Under these circumstances what may happen to the buildings during the remaining period of the lease is problematical and is distinctly different from a case where legislation prohibits the future use of the buildings for the purposes erected, and for which purpose they were specially designed and constructed and not "readily adaptable to other uses." The commissioner in the present case did not refuse an obsolescence allowance. On the contrary, as previously observed, the plaintiff obtains a return of its capital investment; the only issue in the present case is as to the year in which the deduction of obsolescence of tangible property should be allowed. In the Niagara case (supra) the Supreme Court said:

"Clearly the statute contemplates that where warranted by the facts, the taxpayer shall have the benefit of, and in making his return may deduct in each year, a reasonable allowance to cover obsolescence of the tangible property,"

a holding in response to a contention upon the part of the United States that the statute did not authorize obsolescence allowance of tangible property in the familiar and so-called prohibition cases, an issue foreign to the record in this case. What the plaintiff is asking here is an anticipation of obsoleteness without a record to support the contention.

Finding 56 discloses the facts with reference to the plaintiff's claim of loss of useful value for a garage erected upon leased premises. We think the facts as found and not disputed bring the claim within what we have said with

reference to the factory buildings. The findings clearly show that the claim may not be sustained.

We think that under the Italian contract the plaintiff is entitled to recover and will enter judgment therefore when the amount of the same is determined. As to the remaining items of the case the court concludes that they are without merit, and no allowance will be made therefor. It is so ordered.

Williams, Judge; Littleton, Judge, and Green, Judge, concur.

Whaley, Judge, took no part in the decision of this case.

(Here follow photostats of side folios 96 and 97.)

96

(EXECUTE SEPARATE FORM FOR EACH TAX PERIOD)

TREASURY DEPARTMENT
INTERNAL REVENUE SERVICE
Form 843—Jan. 1926
Comptroller General U. S.
January 28, 1925

AMENDED CLAIM FOR

- [ ] ABATEMENT OF TAX ASSESSED
- [ ] CREDIT AGAINST OUTSTANDING ASSESSMENTS
- [X] REFUND OF TAXES ILLEGALLY COLLECTED
- [ ] REFUND OF AMOUNTS PAID FOR STAMPS USED IN ERROR OR EXCESS

IMPORTANT
File with Collector of Internal Revenue where assessment was made. Not acceptable unless completely filled in.

COLLECTOR'S NOTATION
District
Account number
Date received
Stamp here
JAN 25 1927
Collector of Internal Revenue

108309
NOTICE TO COLLECTOR
Collector must indicate in block above the kind of claim, except in Income Tax cases.

Date received by Administrative Unit
RECORDED
Stamp here

RECEIVED BOSTON, MASS.
JAN 25 1927
CLAIM DIV. INT. REVENUE.

State of Massachusetts
County of Suffolk ss:

989064

TYPE OR PRINT

United States Cartridge Company
(Name of taxpayer or purchaser of stamps.)

(Residence—give street and number as well as city or town and State.)
Lawrence Street, Lowell, Massachusetts.
(Business address.)

This deponent, being duly sworn according to law, deposes and says that this statement is made on behalf of the taxpayer named, and that the facts given below with reference to said statement are true and complete:

	PERIOD	YEAR
From:	Jan. 1,	19 18
To:	Dec. 31,	19 18

1. Business in which engaged Manufacture of small arms ammunition
2. Character of assessment or tax Income and profits tax
(State for or upon what the tax was assessed or the stamps affixed.)
3. Amount of assessment or stamps purchased $1,152,123.53
4. Reduction of Tax Liability requested (Income and Profits Tax) $ 843,589.12
5. Amount to be abated $
6. Amount to be refunded (or such greater amount as is legally refundable) $ 843,589.12
7. Dates of payment (see Collector's receipts or indorsements of canceled checks) See Exhibit A attached hereto
(If statement covers income tax liability, items 8-11, inclusive, must be answered.)
8. District in which return (if any) was filed Boston, Massachusetts
9. District in which unpaid assessment appears
10. Amount of overpayment claimed as credit $
11. Unpaid assessment against which credit is asked; period from to $

Deponent verily believes that this application should be allowed for the following reasons: See statement annexed

The tax assessed and paid by the taxpayer is $843,589.12 greater than the correct amount under the law, as shown below.

Amount assessed and paid by the taxpayer (See Exhibit A)	$1,152,123.53
Correct amount of tax, according to statement filed herewith	308,534.41
Amount of refund due taxpayer	$ 843,589.12

NOTE. This claim is filed as an amendment of the claim for the same amount filed January 14, 1927. It is identical with said claim except that this amended claim corrects an error made in the claim filed on January 14, 1927, in stating the income of the taxpayer for the year 1918, which error was contained on the 5th page of the statement annexed to the claim in which said income was stated as $1,096,596.72 instead of $768,659.37.

FEB 3 1927
CLAIMS CONTROL SECTION

CONSOLIDATED REC AUDIT DIVISION
ADMINISTRATIVE SECTION
FEB 23 1927

(Attach additional sheets if necessary.)

Sworn to and subscribed before me this 22 day of January, 1927

Signed: Philip R. White

United States Cartridge Co
RECEIVED

989064

IMPORTANT
File with Collector of Internal Revenue where assessment was made. Not acceptable unless completely filled in.

☐ STATEMENT OF TAX ASSESSED
☐ CREDIT AGAINST OUTSTANDING ASSESSMENTS
☒ REFUND OF TAXES ILLEGALLY COLLECTED
☐ REFUND OF AMOUNTS PAID FOR STAMPS USED IN ERROR OR EXCESS

District
Account number
Date received

108309

NOTICE TO COLLECTOR
Collector must indicate in block above the kind of claim, except in Income Tax cases.

Date received by Administrative Unit
RECEIVED BOSTON, MASS.
RECORDED
Stamp here
JAN 25 1927
Collector of Internal Revenue

State of Massachusetts
County of Suffolk ss: 1927

TYPE OR PRINT

United States Cartridge Company
(Name of taxpayer or purchaser of stamps.)
CLAIM DIV. INT. REVENUE

(Residence—give street and number as well as city or town and State.)
Lawrence Street, Lowell, Massachusetts.
(Business address, if different.)

This deponent, being duly sworn according to law, deposes and says that this statement is made on behalf of the taxpayer named, and that the facts given below with reference to said statement are true and complete:

1. Business in which engaged Manufacture of small arms ammunition
2. Character of assessment or tax Income and profits tax
(State for or upon what the tax was assessed or the stamps affixed.)

PERIOD	YEAR
From: Jan. 1,	19 18
To: Dec. 31,	19 18

3. Amount of assessment or stamps purchased $1,152,123.53
4. Reduction of Tax Liability requested (Income and Profits Tax) $ 843,589.12
5. Amount to be abated $
6. Amount to be refunded (or such greater amount as is legally refundable) $ 843,589.12
7. Dates of payment (see Collector's receipts or indorsements of canceled checks) See Exhibit A attached hereto
(If statement covers income tax liability, items 8-11, inclusive, must be answered.)
8. District in which return (if any) was filed Boston, Massachusetts
9. District in which unpaid assessment appears
10. Amount of overpayment claimed as credit $
11. Unpaid assessment against which credit is asked; period from to $

Deponent verily believes that this application should be allowed for the following reasons: See statement annexed

The tax assessed and paid by the taxpayer is $843,589.12 greater than the correct amount under the law, as shown below.

Amount assessed and paid by the taxpayer (See Exhibit A) $1,152,123.53
Correct amount of tax, according to statement filed herewith. 308,534.41
Amount of refund due taxpayer $ 843,589.12

NOTE. This claim is filed as an amendment of the claim for the same amount filed January 14, 1927. It is identical with said claim except that this amended claim corrects an error made in the claim filed on January 14, 1927, in stating the income of the taxpayer for the year 1918, which error was contained on the 5th page of the statement annexed to the claim in which said income was stated as $1,096,596.72 instead of $768,659.37.

FEB 8 1927
CLAIMS CONTROL
SECTION

CONSOLIDATED REC
AUDIT DIVISION
ADMINISTRATIVE SECTION
FEB 23 1927

(Attach additional sheets if necessary.)

Sworn to and subscribed before me this 22 day of January, 1927

Signal:

Philip R. White
Notary Public
(Title.)
My Commission expires Nov. 17, 1933

United States Cartridge Co
RECEIVED
by W. F. Whittier Treasurer

(This affidavit may be sworn to before a Deputy Collector of Internal Revenue or Revenue Agent without charge.)

11704

110A

97

CERTIFICATES

I certify that an examination of the records of the Bureau of Internal Revenue shows the following facts as to the assessment and payment of the tax:

NAME OF TAXPAYER.	Character of assessment and period covered.	List.	Year.	Month	Page.	Line.	Amount.	Date paid.	District in which paid.
	Corp 1918	Reg	1919	Corrected			$		
			40593V						
		Cert	1926	Jan	20	6			

Thomas W. Lewis

Collector of Internal Revenue

Assessment Clerk Commissioner's Office

Schedule No.

Claim No.

I certify that the records of my office show the following facts as to the purchase of stamps:

TO WHOM SOLD OR ISSUED.	Kind.	Number.	Denomination.	Date of sale or issue.	Amount.	If special tax stamp, state: Serial number.	If special tax stamp, state: Period commencing
					$		

REJECTED
6994

Collector ..... District .....

Schedule Number .....

District .....

Allowed or Rejected Number .....

(Nature of tax.)

Claimant .....

Address .....

Examined and submitted for action ....., 19....

COMMITTEE ON CLAIMS

Claim examined by— Paul 3/21/27

Claim approved by—

Chief of Division.

Amount claimed... $ 843589.12

Amount allowed... $

Amount rejected... $ 843589.12

Schedule No.

Claim No.

8—15106

GOVERNMENT PRINTING OFFICE

LHUD 9

[fol. 98] Statement Annexed to Claim of United States Cartridge Company for Refund of Income and Profits Taxes for the Year 1918

The claim of the United States Cartridge Company for refund of income and profits taxes paid for the year 1918 is based upon the following facts:

1. The Commissioner of Internal Revenue (hereinafter called the Commissioner), in determining the total taxes payable for said year, has valued certain goods and materials forming a part of the taxpayer's inventory on hand at the end of the year at amounts which are greatly in excess of the market value of such goods and materials, thereby making it appear that the income of the taxpayer was largely in excess of its actual income for said year. The taxpayer had duly elected to take its inventory on the basis of "cost or market whichever is lower" prior to the time of this inventory. The goods and materials in question include:

(a) manufactured and partly manufactured 9 m/m cartridges and the materials for the manufacture of the same. These cartridges were being manufactured by the taxpayer under a contract with the Maxim Munitions Corporation, for the purpose of being supplied to an Italian purchaser who had contracted to purchase the same from the Maxim Munitions Corporation. Before the end of the year 1918 the Italian purchaser had declined to take further deliveries of these cartridges, claiming that the seller, the Maxim Munitions Corporation, was in default under its contract. The Maxim Munitions Corporation was insolvent and unable to pay for further deliveries of cartridges. The cartridges were manufactured under specifications which made them suitable for use only in machine guns of the type used in the Italian army, and there was no market for these cartridges or for the work in process except as scrap at the time when the Italian purchaser declined to take them, or at any time later. The market (scrap) value of the completed cartridges, work in process and materials on hand intended for use under this contract at the end of the year 1918 was $79,297.11. The employees of the Company [fol. 99] in taking its inventory at the end of the year 1918, erroneously took such cartridges, work in process and materials at a figure which was neither cost nor market value. This inventory was taken in the midst of the great confusion arising from the termination of the war and of

the Company's war contracts. Subsequently, after the Company had been required by the Treasury Department to correct the valuation of certain other items in its inventory, the Company filed schedules showing the market value of such cartridges, work in process and materials and requested that its taxes be determined on the basis of such market value. Nevertheless, in determining the taxes for the year 1918, the Commissioner has taken such cartridges, work in process and materials in the inventory at the end of the year 1918 at $274,659.78. The fair market value of such cartridges, work in process and materials at the end of the year 1918 was $79,297.11.

(b) The taxpayer had on hand at the end of the year 1918 a large quantity of materials and work in process intended for use under contracts between the taxpayer and the United States calling for the manufacture and delivery by the taxpayer of finished articles, chiefly small arms ammunition and artillery primers, at prices fixed in the contracts. Work upon these articles had been suspended at the direction of the United States between the date of the Armistice (November 11, 1918) and December 31, 1918, on the understanding that the United States would negotiate a settlement with the Company on account of the suspension of such work. The contracts involved in the question now under consideration, and the dates of the suspension notices are as follows:

P6489-1489Sa, December 20, 1918.
P12289-3034A, December 12, 1918.
GA 126, December 16, 1918.
P12621-3124A, December 14, 1918.

These negotiations were not completed until after December 31, 1919, and the material was, with minor exceptions, still in the possession of the Company until the spring of 1920, when the United States agreed to take possession of the greater part of this material and to reimburse the Company for it at cost. The Government eventually declined, however, on one ground or another, to take over a considerable quantity of such material and work in process.

Until these agreements were reached in 1920, the Company had no enforci-ble rights by which it could require the Government to take over this material and to pay cost for it. Whatever rights the Company had were rights arising

from the failure of the United States to continue to accept [fol. 100] performance under the contracts. It was not known until after December 31, 1919, whether the taxpayer would eventually receive its compensation for work in process under such settlements as were later made by which the Government took over the articles at cost, or would have to sell the articles as scrap for what they would bring and institute suits against the United States for the difference between such amounts and cost.

With respect to certain of these contracts a question existed as to whether they had been executed in the form required by law and were enforci-ble against the United States. The Company in its own inventories taken on December 31, 1918, had in general valued such work in process at cost, and these inventories were used as a basis for the returns originally filed by the Company. When the examination of the taxpayer's returns was made, however, the Revenue Agent required the taxpayer to revalue a portion of its inventory. Thereupon the taxpayer claimed the right to revalue also that portion of its inventory which consisted of these partly manufactured articles, and has revalued them on the basis established by the regulations for valuation of such articles under the abnormal conditions which existed at the date of each of the inventories in question.

Such revaluation was made on the basis of the cost or actual market value of the material, whichever was lower. The Commissioner, however, in determining the amount of the taxpayer's taxes for the year 1918, has declined to permit the valuation of this material and work in process at market value where the market value was lower than cost, but has taken said articles in the taxpayer's inventory at the end of the year 1918 at valuations which were greatly in excess of the market value on said date, thereby greatly increasing the apparent income of the taxpayer for the year 1918 as determined by him over the amount of the real income of the taxpayer for said year. The correct valuation at the end of the year 1918 of such material and work in process, the value of which was in question between the Commissioner and the taxpayer if taken at "cost or market whichever is lower", was $231,615.43. The Commissioner in determining the income of the taxpayer for said year has valued such material and work in process at the end of the year 1918 at $732,088.62.

By reason of the overvaluations of the inventory of the taxpayer, hereinbefore described, the Commissioner, in determining the taxes of the taxpayer for said year 1918, has made it to appear that the income of the taxpayer for said year was in excess of its actual income by $695,835.86. This amount is computed as follows:

[fol. 101] Overvaluation of Maxim Contract Inventory:		
Valuation by the Commissioner	$274,659.78	
"Cost or market" value	79,297.11	
		$195,362.67
Overvaluation of Govt. Contract Inventory:		
Valuation by the Commissioner	$732,088.62	
"Cost or market" value	231,615.43	
		500,473.19
Total		$695,835.86

For a further statement of the facts and principles applicable to the valuation of the inventories hereinabove described in this claim, reference is made to the taxpayer's appeal dated May 8, 1924, heretofore filed (IT:CR:CES:-APP) and particularly to pages 33 to 38 thereof and to the documents therein mentioned.

2. The Commissioner, in determining the income of the taxpayer for the year 1918, has disallowed a deduction claimed by the taxpayer for that year, amounting to $327,-937.35. The taxpayer is entitled to this deduction by reason of the loss of useful value of certain buildings erected by the taxpayer on leased land for war purposes and at abnormal expense, which buildings in the year 1918 became no longer useful for such purposes on account of the termination of hostilities and the consequent cessation of the demand for munitions. The claim is for the difference between the cost of these buildings (after allowance for depreciation) and the value of the right to use these buildings for normal purposes during the remainder of the term of the lease. At the expiration of the lease of the buildings [fol. 102] on December 31, 1924, the buildings were to revert to the landlord in lieu of rent, and they did in fact so revert to the landlord. The claim is made for loss of useful value of such buildings ~~or portions~~ of buildings as were

not required for the business of the taxpayer after the war business ceased. The cost of such buildings or portions of buildings as were erected for war purposes and were not required for the normal business of the Company (after deduction of proper depreciation) exceeded by $327,937.35 the value on December 31, 1918, of the right to use such buildings or portions of buildings for the remainder of the term of the lease. The taxpayer claims a deduction of this amount in computing its taxable income for the year 1918.

The facts relating to this claim are stated in the appeal filed on June 28, 1923, from the decision of the Amortization Section of the Income Tax Unit which was contained in the report of that Section dated May 1, 1922, and in its revised report dated December 13, 1922, and in the other papers on file on which said reports and appeal were based.

If the taxpayer's inventories had been correctly valued by the Commissioner on the basis of "cost or market whichever is lower" and the Commissioner had allowed the deduction for loss of useful value hereinbefore described, the taxable income of the taxpayer for the year 1918 would have been reduced from the amount found by the Commissioner as such income, namely, $1,792,432.58 to $768,659.37 which the taxpayer alleges to be the correct amount of its income for said year 1918, and in consequence, the income and profits taxes properly to be assessed for said year 1918 [fol. 103] would have been $308,534.41 which is the correct amount of such taxes. The amount assessed and paid for said year, as stated in Exhibit A hereto annexed, was $1,152,123.53. The taxpayer claims a refund of the difference between said amounts, or $843,589.12 with interest thereon as provided by statute.

This claim for refund is supplemental to a claim for refund of taxes paid for the year 1918 which was filed by the taxpayer in February 1924 and was disallowed on January 20, 1926. Since said claim for refund was filed an additional assessment of taxes amounting to $642,914.24 has been made upon the taxpayer for said year 1918 and this amount has been paid as stated in Exhibit A annexed.

United States Cartridge Company, by W. R. B. Whittier, Treasurer.

Sworn to and subscribed before me this 22 day of January, 1927. Philip R. White, Notary Public. My Commission expires Nov. 17, 1933. (Seal.)

[fol. 104]

Payments of Tax

Payments on original assessment of $509,209.29:		
Cash:		
March 15, 1919	$300,000.00	
June 14, 1919	300,000.00	
Sept. 13, 1919	300,000.00	$900,000.00
Less credits on account of overpayment, said by collector to have been applied in June, 1923, to assessment for 1919 (See Exhibit B) Claim Filed:		
March 15, 1920	150,000.00	
June 15, 1920	150,000.00	
Sept. 15, 1920	54,279.38	
Dec. 15, 1920	36,511.33	390,790.71
Paid on original assessment		509,209.29
Payments on additional assessment of $642,914.24, January, 1926:		
Credits, January, 1926, on account of certificates of overassessment (See Exhibits C, D and E):		
For 1917	3,147.01	
For 1919	409,416.89	412,563.90
Cash—April 1, 1926		230,350.34
Paid on additional assessment		642,914.24
Payments on total assessments		$1,152,123.53

[fol. 105] EXHIBIT B

Copy

Treasury Department, Internal Revenue Service,
Boston, Mass.

IT:JAC.

January 12, 1926.

United States Cartridge Company, Lowell, Massachusetts.

Attention W. R. B. Whittier, Treasurer. In re 1919 Tax

DEAR SIR: In compliance with your request of the 2nd instant, you are respectfully advised that investigation of the above account discloses the original tax to be $472,372.50 against which payment of $54,717.68 was made December 16, 1920, and a credit of $390,790.71 for 1918 was applied in June 1923, leaving a balance of $26,864.11, which at the present time is outstanding with a claim filed against it.

The records also disclose that a waiver was signed February 14, 1925 extending the period of limitation to December 31, 1926.

Respectfully, Thomas W. White, Collector.

JAC:O'B.

[fol. 106]

EXHIBIT C.

Copy.

Notice and Demand for Income Tax.

Form 17A. U. S. Internal Revenue. Revised January, 1924. 2-9487.

Tax	Amount paid	Balance payable	Remarks
642,914.24	Cr. 409,416.89		1918 Addl. Income RAR Waiver.
	Cr. 3,147.01	230,350.34	Jan. 1926 Addl. Spl. 7.
			P O L 6 C.
			OL 12-4-25.

Notice is hereby given that there has been assessed against you the amount of tax stated above. Demand is hereby made for the immediate payment of said tax. If payment is not made within ten days after date of this notice, the Act Provides that [a penalty of 5 per cent]* of the amount of tax due will be added, [plus]* interest at the rate of 1 per cent per month, until paid.

Date: Mar. 24, 1926.

United States Cartridge Co., Lawrence St., Lowell, Mass.

Jan., 1926. Addl. Spl. 7. Spl. 7. 0-6 C.

To avoid penalty and interest this tax must be paid within 10 days from the above date to the Collector of Internal Revenue at Boston, Mass.

Return this form with remittance. Date: —— —, ——.

To the Collector of Internal Revenue:

I inclose herewith the sum of $— in payment of the tax shown above.

Name: —— ——, Address: ——.

[*Words enclosed in brackets erased in copy.]

[fols. 107-162] EXHIBIT D

Copy

Treasury Department

Office of

Commissioner of Internal Revenue, Washington

Income Tax Unit

IT:R:CC.

Certificate of overassessment: Number: 79919. Allowed: $3,147.01. Schedule No.: 17865.

United States Cartridge Company, Lawrence Street, Lowell, Massachusetts.

SIRS: An audit of your income tax return, Forms 1031-1103, and a consideration of all the claims (if any) filed by you for the year 1917 indicates that the tax assessed for this year was in excess of the amount due:

Original assessment (1754226)	$126,102.87
Tax Liability	122,955.86
Overassessment	3,147.01

The adjustments producing this overassessment of $3,-147.01 are contained in schedules attached to a separate communication addressed to you.

In the determination of this overassessment, the statements made in your claims for the refund of $26,864.11, $45,199.94 and $20,867.19 and those for the credit of $1,-547.11 and $26,864.11 corporation income and profits tax, for 1917 have been given careful consideration.

This refund or credit is made in accordance with the provisions of Section 281 (e) of the Revenue Act of 1924.

The amount of the overassessment will be abated, credited, or refunded as indicated below. (You will be relieved from the payment of any amount abated; if an overpayment has been made and other taxes are due, credit will be made accordingly, and any amount refundable is covered by a Treasury check transmitted herewith.)

Included in the accompanying check is interest in the amount stated below, allowed on the refund or credit.

Respectfully, C. R. Nash, Ass't to the Commissioner, Deputy Commissioner, (Signed) by H. B. Robinson, Head of Division.

Abated: $—.
Credited: $3,147.01.
Year: 1918A.
Account No. Jan. 1926 O-6C Spl. 7.
Refunded: $—.
Interest: $—.
Instructions Executed.
Signature: (Signed) T. W. White, Collector Int. Rev., District of Mass.
J. H. R.

NOTE.—The interest, if any, included herein is taxable income, and must be included in your income tax return for the year in which received.

[fol. 163] EXHIBIT 11

War-Ord.-P 6489-14898a

The United States of America and United States Cartridge Company

War Department, Office of the Chief of Ordnance, Procurement Division

Fixed Price Contract

60,100,000 Ball Cartridges, Caliber .45, for Pistol and Revolver, Model of 1911

Dated May 6, 1918

Washington

Government Printing Office

1918

[fol. 164] These articles of agreement, entered into this 6th day of May, 1918, by and between United States

Cartridge Company, a corporation organized and existing under and by vitrue of the law of the State of Massachusetts, and having its principal office at Lowell, Massachusetts (hereinafter called the Contractor), party of the first part, and the United States of America, acting through and represented by William Williams, Lieutenant Colonel, Ordnance Department, United States Army (hereinafter called the Contracting Officer), duly authorized, under authority of the Secretary of War, to make and execute contracts to be performed under the direction of Samuel McRoberts, Brigadier General, Ordnance Department, United States Army, or his successor, as head of the Procurement Division, Office of the Chief of Ordnance, party of the second part,

Witness:

Whereas a state of war exists between the United States of America and the Imperial German and the Imperial and Royal Austro-Hungarian Governments, and therefore the usual requirements of advertisement for proposals are dispensed with:

Now, therefore, under the laws of the United States in such cases made and provided, and in consideration of the mutual agreements herein contained, it is agreed that the Contractor shall manufacture sixty million one hundred thousand (60,100,000) shell cartridges, caliber .45, for pistol and revolver, Model of 1911, packed without clips, except that not to exceed one-third of the cartridges shall be packed with clips. The quantity of the cartridges to be [fol. 165] packed with clips will be specified by the Ordnance Department, United States Army.

The Contractor agrees to manufacture the cartridges in accordance with the drawings and specifications referred to in Schedule 1 hereto attached and made a part hereof, and such changes in the specifications as made by a letter from the Machine Gun Small Arms Section, Engineering Bureau, Ordnance Department to Inspection Division, Small Arms Ammunition Section, Ordnance Department, a copy of which is set forth in Schedule 1 and such further changes in the drawings and specification as may be made, as herein provided, and deliver the same f. o. b. cars at the Contractor's plant at Lowell, Massachusetts, at the rate of at least ten million (10,000,000) monthly, beginning during the month of August, 1918, for the consideration of which

the United States agrees to pay to the Contractor as hereinafter provided.

The Contractor shall, at the cost of the United States, ship the cartridges to any point in the United States designated by the Chief of Ordnance and shall make all the necessary freight and shipping arrangements.

The United States agrees to pay to the Contractor as a just and fair compensation the sum of twenty-eight and twenty-five one-hundredths dollars ($28.25) for each one thousand of the cartridges packed without clips, delivered to and accepted by the United States.

The United States agrees to pay to the Contractor as a just and fair compensation the sum of twenty-nine and twenty-five one-hundredths dollars ($29.25) for each one thousand of the cartridges packed with clips, delivered to and accepted by the United States.

[fol. 166] The compensation for each one thousand cartridges is based upon materials and component parts at the following prices:

Copper, at twenty-three and one-half cents ($0.235) per pound.

Lead, at six and one-half cents ($0.065) per pound.

Spelter at thirteen and one-half cents ($0.135) per pound.

It is agreed that for all variations from the above schedule of prices of materials and component parts purchased by the Contractor, whether upward or downward, a corresponding adjustment will be made in the compensation for each one thousand cartridges, it being the intention of this contract that the Contractor shall neither profit nor lose by any fluctuation in the prices of such materials.

Payments will be made in the following manner:

1. Upon the proper certificate of the inspecting and receiving officer showing delivery and acceptance the United States will pay to the Contractor the compensation above allowed, except that from all such payments there will be retained by the United States a sum equal to 5 per cent thereof until the performance of this Contract has been completed or further performance has been waived.

2. Upon the certificate of the Chief of Ordnance that the performance of this Contract has been completed or that further performance has been waived the United States will pay to the Contractor the remainder of the compensa-

tion until then withheld, except that there shall be retained an amount sufficient to protect the United States on claims of the United States against the Contractor, if any, until [fol. 167] the final settlement or adjustment of such claims.

The United States agrees to furnish to the Contractor, at the plant of the Contractor, without cost to the Contractor, the clips necessary for the performance of this Contract, in quantities determined by the Chief of Ordnance to be requisite, and at such times as will enable the Contractor to deliver the cartridges in accordance with the schedule of deliveries hereinafter set forth.

The United States may, from time to time, furnish the Contractor component parts and materials required in the performance of this Contract in addition to or substitution for such components as herein provided for: Provided, however, That the Contractor's undertaking for such additional components or material previously made in good faith are not interfered with. With respect to any components the source of the Contractor's supply of which has failed or is likely to fail, it shall be the duty of the Contractor, immediately upon being apprised of such failure or probable failure, to notify the Chief of Ordnance, so that the United States may, if it is deemed desirable so to do, arrange for a supply of such components.

Unless it is specifically provided that they shall be furnished without charge, such components shall be accepted by the Contractor at the estimated cost of such components used in determining the contract price of the articles, and the compensation to be paid by the United States for the cartridges shall be reduced by an amount equal to the total of such prices of components so furnished by the United States.

All components furnished by the United States will be in [fol. 168] accordance with the requirements under the specifications and will remain the property of the United States. The Contractor will use due and proper care in handling and storing such property, will account for all such components in finished product, scrap, unused material or otherwise, and will make such disposition thereof as may be ordered in writing by the Chief of Ordnance.

This contract will be performed under the following terms and conditions:

Article I. The Contractor shall give to the performance of this Contract preference and priority over any work or engagements, other than work heretofore given priority by the United States. The Contractor shall undertake to increase production to such a maximum rate as facilities and equipment permit and to complete the performance of this Contract at an earlier date than herein fixed, anticipating deliveries in so far as possible. Deliveries in advance of the dates or in excess of the quantities scheduled may be credited on subsequent delivery obligations.

The Contractor shall, from time to time, and whenever requested so to do, furnish to the Chief of Ordnance statements and reports on the progress of the work and any factors bearing on deliveries.

The Contractor shall use its best efforts to safely and adequately store any accepted cartridges at the cost and risk of the United States for as long a period as the Chief of Ordnance shall deem necessary. Cartridges so stored shall be deemed to have been delivered, for the purpose of payment.

Article II. All components unused or in process, the machinery, the equipment, and the plant used in the performance of this contract and the finished cartridges shall [fol. 169] at all times be subject to inspection by persons designated by the Chief of Ordnance, and the Contractor shall furnish reasonable facilities and assistance for all such inspection. Whatever of the components, not furnished by the United States, or of the cartridges do not in all respects fulfill the requirements of this contract, shall be rejected, and the decision of the Chief of Ordnance as to the quality thereof shall be final. The Chief of Ordnance may require the replacement of all such components and cartridges so rejected, and the United States may withhold out of the payments to be made hereunder, an amount sufficient to cover the cost thereof until such proper replacement.

The process of manufacture shall be subject to the inspection and supervision of the Chief of Ordnance and any changes therein directed by him shall be made and the cost thereof will be paid by the United States.

Upon notice from the Contractor that the cartridges, or any of them, are completed and ready for delivery, final inspection will be promptly made by the United States.

Article III. The Contractor will not be held responsible for delays in delivery determined by the Chief of Ordnance to have been due to causes beyond the control or without the fault of the Contractor, but, simultaneously with the removal of such causes for delay, the Contractor shall proceed with the performance of this Contract, allowance for such delay having been made. In view of the emergency necessitating this Contract, the Contractor shall use its best endeavors to remove such cause for delay.

In the event of the Contractor's inexcusable default in making the deliveries, herein scheduled, the Chief of Ord- [fol. 170] nance may cancel this Contract without prejudice to any claim of the United States hereunder, and complete the manufacture or purchase elsewhere, or all or any of the cartridges herein contracted for then remaining undelivered and charge the Contractor with all loss, damage, and expense in excess of the contract price of the cartridges incurred as a result of such action.

Article IV. The Chief of Ordnance may, by written notice to the Contractor at any time, make changes in the drawings and specifications or supplemental or substituted drawings and specifications which relate to, form a part of, or are added to this Contract. If such changes involve additional expense, a fair addition may be made to the contract price, but if such changes involve less expense a fair deduction may be made therefrom, all as shall be determined by the Chief of Ordnance. No claim on account of any such change will be made or allowed unless the same has been ordered in writing by the Chief of Ordnance.

Article V. This Contract being necessitated by a state of war now existing between the United States of America and the Imperial German and the Imperial and Royal Austro-Hungarian Governments, it is desirable and expedient that provision be made for its cancellation upon fair and equitable terms in the event of the termination or limitation of the war, or if in anticipation thereof or because of changes in methods of warfare the Chief of Ordnance should be of the opinion that the completion of this Contract has become unnecessary. It is therefore provided that at any time, and from time to time, during the currency of this Contract, the Chief of Ordnance may notify the Contractor that any part or parts of the cartridges

herein contracted for then remaining to be delivered shall not be manufactured or delivered.

[fol. 171] In the event of the cancellation of this Contract, as in this article provided, the United States will inspect the completed cartridges then on hand and such as may be completed within thirty (30) days after such notice, and will pay to the Contractor the price herein fixed for the cartridges accepted by and delivered to the United States. The United States will also pay to the Contractor the cost of the component materials and parts then on hand in an amount not exceeding the requirements for the completion of this contract, which shall be in accordance with the specifications referred to in Schedule 1 hereto attached, and also all costs theretofore expended and for which payment has not previously been made and all obligations incurred solely for the performance of this Contract of which the Contractor cannot be otherwise relieved. To the above may be added such sums as the Chief of Ordnance may deem necessary to fairly and justly compensate the Contractor for work, labor, and service rendered under this Contract.

Title to all such component material and parts paid for by the United States under this article shall, immediately upon such payment, vest in the United States.

The United States may refuse to make any payment or to reimburse the Contractor for or on account of component material or parts intended to form a part of the cartridges delivered under this Contract, whether unused or in the process of manufacture or manufactured, in respect to the delivery of which cartridges the Contractor shall be in inexcusable arrears at the time of such termination or cancellation.

The decision of the Chief of Ordnance as to payments and allowances to the Contractor under this Article, made [fol. 172] in accordance with the terms of this Contract and with the "Definition of 'Cost' Pertaining to Contracts" issued by the Finance Division, Ordnance Department, United States Army, dated June 27, 1917, made a part hereof by reference, will be final and binding on both parties hereto.

The foregoing provision with regard to payments to be made by the United States upon the cancellation of this contract shall also apply in the event that performance by

the Contractor of this contract is finally prevented by causes determined by the Chief of Ordnance to have been beyond the control or without the fault of the Contractor.

Article VI. The Contractor hereby, for the consideration herein named, waives and releases all lien or right of lien now existing or that may hereafter arise for work or labor performed or materials furnished or for any other reason or cause under this contract, under any lien laws, State or Federal, upon any component parts, material, supplies, and the like coming into its possession, which it is herein contemplated shall presently or ultimately become the property of the United States, and the Contractor agrees not to create or suffer to be created any mortgage, lien, pledge, attachment, or other encumbrance upon any such component parts, material, supplies, or other such property in its possession intended to form a part of the cartridges to be delivered under this contract. In the event that such mortgage, pledge, lien, attachment, or encumbrance is created, the Contractor agrees to pay and discharge, or, if it disputes the validity of the claim out of which such encumbrance arises, immediately to bond the same to the end that all property shall at all times be and remain free from all encumbrances.

[fol. 173] Article VII. No Member of or Delegate to Congress or Resident Commissioner is or shall be admitted to any share or part of this Contract or to any benefit that may arise therefrom; but this Article shall not apply to this Contract so far as it may be within the operation or exception of section 116 of the Act of Congress approved March 4, 1909 (35 Stats., 1109).

Article VIII. Neither this Contract nor any right to receive payment hereunder shall be assigned to any person, firm, or corporation.

The Contractor shall insert in every contract hereafter made for increased facilities, component parts, labor, material, supplies, and the like, or otherwise relating to the performance of this Contract, a provision that such contract may be assigned by the Contractor and that it relates to a "main contract" between the Contractor and the United States.

Article IX. No person or persons shall be employed in the performance of this Contract who are undergoing sen-

tences of imprisonment at hard labor which have been imposed by the courts of the several States, Territories, or municipalities having criminal jurisdiction.

Article X. Except as this Contract shall otherwise provide, any doubts or disputes which may arise as to the meaning of anything in this Contract shall be referred to the Chief of Ordnance for determination. If, however, the Contractor shall feel aggrieved at any decision of the Chief of Ordnance upon such reference it shall have the right to submit the same to the Secretary of War, whose decision shall be final and binding on both parties hereto.

Article XI. Wherever the term "Chief of Ordnance" is [fol. 174] used in this Contract the same shall be construed to include the Acting Chief of Ordnance or any person designated to act as the Chief of the Ordnance Department, United States Army, or any person who is accredited as his duly authorized representative.

Article XII. Notice under this Contract when not actually given shall be deemed to have been sufficiently given to and received by the Contractor when mailed in a sealed postpaid wrapper to the Contractor at Lowell, Mass.

Article XIII. The Contractor agrees to hold and save the United States and all persons acting under them, harmless from, and against all liability on account of any patent rights granted by the United States which may affect the cartridges herein contracted for, or their manufacture, or the performance of this Contract in any manner whatsoever.

Article XIV. The Contractor agrees to refrain from giving any information whatsoever relative to any experiments that may be carried out by it at the instance of the United States.

Article XV. In the event that labor disputes shall arise directly affecting the performance of this Contract and causing or likely to cause delay in making the deliveries upon the date or dates specified, the Contractor shall address a written statement thereof to the Chief of Ordnance for transmission to the Secretary of War with the request that such dispute be settled, providing such information and access to information within the control of the Con-

tractor as the Secretary of War require, and it is stipulated and agreed that the Secretary of War may thereupon settle or cause to be settled such dispute, and that the Contractor shall accept and comply with all the terms of such settlement. If the Contractor is thereby required to [fol. 175] pay labor costs higher than those prevailing in the performance of this Contract prior to such settlement, a fair addition to the basic purchase price of the articles shall be made therefor; but if such settlement reduces the labor costs of the Contractor, a fair deduction shall be made from the basic purchase price, all as may be determined by the Contracting Officer. No claim for addition or deduction on account of such settlement shall be allowed unless the same has been ordered in writing and actually put into effect.

Article XVI. In addition to the ordinary precautions heretofore adopted by the Contractor for the guarding and protection of his plant and work, the Contractor shall provide such additional watchmen and devices for protection of his plants and property and the work in process for the United States against espionage, acts of war, and of enemy aliens as may be required by the Chief of Ordnance. The Contractor shall, when required, report to the Chief of Ordnance the citizenship, country of birth, or alien status of any and all of its employees. When required by the Chief of Ordnance the Contractor shall refuse to employ, or if already employed, forthwith discharge from employment and exclude from its works any person or persons designated by the Chief of Ordnance for cause as undesirable for employment in a plant engaged on work for the United States. The United States shall pay to the Contractor as part of the cost of the cartridges any expense incurred by the Contractor which shall be determined by the Chief of Ordnance to be directly caused by the requirements of this Article.

[fol. 176] In witness whereof the parties hereto have caused this Contract to be executed under their seals (in

triplicate) by their respective officers, duly authorized, the day and year first above written.

Signatures: United States Cartridge Company, Contractor, (Signed) by Butler Ames, Chief Executive & Treasurer. United States of America, (Signed) by Wm. Williams, Lieut. Colonel, Ordnance Department, U. S. A., Contracting Officer.

Witnesses: (Signed) C. R. Hoxie, Agt. (Signed) F. R. Thompson.

Approved: —— ——.

Contract Section: —— ——. Negotiating Section: —— ——.

[fol. 177] Schedule 1 Attached to and a Part of a Certain Contract Between the United States of America and the United States Cartridge Company, War-Ord.-P6489-1489SA

Each and every of the pamphlets, drawings, specifications, and other papers enumerated is made a part of the schedule and of the Contract of which this schedule is a part.

In accordance with Ordnance Office Drawing, Class 47, Division 1, Drawing 5, last revised April 29, 1918.

In accordance with Ordnance Office, Pamphlet, No. 514, under revision date of July 18, 1917, and further revised as per letter hereinbelow set forth:

War Department, Engineering Bureau, 481 Pennsylvania Avenue

April 13, 1918.

Memorandum from: Machine Gun Small Arms Section.

To: Inspection Div., Small Arms Ammunition Section.

Subject: Specifications for .45 caliber, Model of 1911, Pistol Ball Ammunition.

1. Attention is invited to the fact that specifications for .45 caliber pistol ball ammunition are now being revised. In view of the fact that new contracts are now being placed with the Remington Arms U. M. C. Company, the United

States Cartridge Company, the Winchester Repeating Arms Company, and the Peters Cartridge Company for these cartridges, it is requested that these companies be informed of the principal changes in this proposed revision of specifications. An outline of the principal changes with explanations is given below.

The Bullet: Different manufacturers are at present [fol. 178] making the core of the bullet of different degrees of hardness and composition and of varying lengths. The practice at the present time is as follows:

At Frankford Arsenal the core is made of lead 30 parts and tin 1 part. The length is 0.672-0.652.

At the Remington Company the core is made of lead 40 parts and 1 part antimony. The length is 0.675-0.655.

At the United States Cartridge Company the core is made of lead 98 parts and 2 parts antimony. The length is 0.672-0.652.

At the Winchester Company the core is made of pure lead and the length is 0.650-0.630.

It is not known definitely what the Peters Cartridge Company is doing.

In the revised specifications, all manufacturers will be required to make the core of lead, hardened with about 1½ per cent of antimony, and to make the length of the bullet 0.672-0.652.

Push Test: The push test will be deleted from the specifications, and in its place a pull test substituted. It will be stipulated that the force required to extract the bullet from the case shall not be less than 40 pounds.

Indents: At present it is specified that the bullet shall be secured in the shell by three indents 0.06 inch wide by 0.025 deep. The restrictions to shape shall be removed and the Contractor permitted to use any shape he prefers, provided the indents do not cut through the cartridge case.

Cannelure on Case: The present restriction that the cannelure, or groove, on the case shall be placed in such position that the bullet does not touch it, is removed. The cannelure is obviously intended as a seating of the bullet to prevent it being pushed into the case, and it should be [fol. 179] placed as near the base of the bullet as is practically possible.

2. Revised drawings will be issued in the course of the next few days, and should be acted upon as soon as can conveniently be done.

Earl McFarland, Lieut. Col., Ordnance, N. A., by
Lee O. Wright, Major, Ordnance, N. A.

[fol. 180] EXHIBIT 12

WAR-ORD-P6489-1489Sa

United States Cartridge Company and United States of America

Ordnance Department, U. S. Army

First Supplemental Contract on Fifth and Sixth Amendments

Dated December 18, 1918

HFG:HW:RBW.

[fol. 181] This first supplemental contract, entered into this 18th day of December, 1918, between the United States Cartridge Company, a corporation organized and existing under and by virtue of the laws of the States of Massachusetts, and having an office in the city of Lowell, State of Massachusetts, party of the first part, (hereinafter called the Contractor), and the United States of America, by —— —— (hereinafter called the Contracting Officer), acting by direction of the Chief of Ordnance, United States Army, and under authority of the Secretary of War, party of the second part,

Witnesseth:

Whereas, the parties hereto entered into an original contract numbered War-Ord-P6489-1489Sa, dated May 6, 1918, for 60,100,000 Ball Cartridges, Calliber .45 for Pistol and Revolver, Model of 1911 packed without clips, except that not to exceed one-third of the cartridges shall be packed with clips, at a price of $29.25 for each 1000 packed with clips, which price is based upon material and component parts as therein specified, f. o. b. cars, Contractor's plant, Lowell, Mass., and

Whereas, the parties hereto desire to amend and supplement said contract in the interest of the United States so as to provide for a change in the powder of the cartridges,

with a consequent increase in the contract price, and to provide for additional articles.

Now, therefore, in consideration of the mutual agreements herein contained, the parties hereto have agreed, and by these presents do agree to and with each other as follows:

Article I. The Contractor shall furnish the articles provided for in the original contract dated May 6, 1918, loaded with DuPont No. 3 powder instead of Pistol powder No. 1, starting with lot No. 650 and all lots thereafter, including one lot No. 636.

Article II. The United States shall pay the Contractor the additional sum of $0.24½ per 1000 for all cartridges loaded as provided for in Article I hereof.

Article III. In addition to the articles provided for in said original contract, said Contractor shall furnish to the United States 18,000,000 Ball Cartridges, caliber .45, Model of 1911, with clips, and 57,000,000 Ball Cartridges, caliber .45, Model of 1911, without clips. Said additional cartridges and clips shall be in accordance with Ordnance Office Specifications, Pamphlet 514, revised May 15, 1918, and in accordance with Ordnance Office Drawing 47-1-5, dated April 29, 1918. Delivery of said additional cartridges shall be made as follows, to-wit:

[fol. 182] 15,000,000 monthly beginning February 1, 1919. Deliveries to be completed by June 30, 1919. The United States will pay the said Contractor in accordance with the conditions set forth in said original contract, for the first 1,000,000 cartridges furnished and delivered under this supplemental contract, the sum of $29.495 per thousand for said cartridges with clips, and the sum of $28.495 per thousand for the cartridges without clips, f. o. b. cars, Contractor's plant, Lowell, Massachusetts. After completion of the first 1,000,000 cartridges provided for in this supplemental contract, said Contractor, and the Contracting Officer shall determine and agree upon the prices to be paid for the remaining cartridges to be delivered hereunder, and in the event of their failure to agree upon such prices for said remaining cartridges such prices shall be determined by the Secretary of War, or his duly authorized representative or representatives.

Article IV. This supplemental contract may be cancelled and terminated upon the same terms and conditions as set forth in Article V of said original contract, except that for the purpose of such cancellation and termination of this supplemental contract the words "and such as may be completed within thirty (30) days after such notice" appearing in said Article V of said original contract, shall be deleted therefrom.

Article V. Except as herein modified, all the terms and conditions of the original contract dated May 6, 1918, shall remain in full force and effect.

In witness whereof the parties hereto have caused this supplemental contract to be duly executed in triplicate, by their duly authorized officers the day and year first above written.

Signatures: United States Cartridge Company, Contractor, by ——. United States of America, by ——, Contracting Officer.

Witnesseth: ——.

[fol. 183] EXHIBIT 13

P471.835 551

Proc. Req. No. #4434. P-Work-Order #4150-4434C.

Duplicate

The United States of America and United States Cartridge Company

War Department, Office of the Chief of Ordnance, Procurement Division

Contract for 49-grain Percussion Primers

Quantity: 8,760,000. Price: $0.09. Total: $788,400.00

Dated July 20, 1918. Expires —— —, ——.

All communications referring to this Contract should be addressed in accordance with directions contained in the

current issue of "Instructions to Contractors," issued by this Department, and should refer to File No. P. #P-12289-3034A, War. Ord. PP.

Washington

Government Printing Office

1918

The Contractor will retain the "Duplicate" copy and, immediately upon execution, return by Special Delivery Mail, all other copies to the Legal Section, Procurement Division Ordnance Department, United States Army, Washington, D. C.

[fol.184] This agreement made this 20th day of July, 1918, between United States Cartridge Company, a corporation organized and existing under and by virtue of the laws of the State of Massachusetts and having (Insert full address) an office at Lowell, Massachusetts, party of the first part, and the United States of America, by Robert P. Lamont, Lt. Colonel, Ordnance Department, National Army, acting by direction of the Chief of Ordnance, United States Army, and under the authority of the Secretary of War, party of the second part,

Witnesseth:

Whereas a state of war exists between the United States and certain foreign countries, constituting a national emergency, and the usual requirements of advertisement for bids are dispensed with,

Now, therefore, the parties hereto, in consideration of the mutual agreements herein contained have agreed and do hereby agree with each other as follows:

Article I. Definitions.—Whenever in this contract the words hereinafter enumerated are used, they shall mean what is set opposite them:

Contractor: The party of the first part and its legal representatives, successors and assigns.

Chief of Ordnance: The Chief of Ordnance, the Acting Chief of Ordnance, or any duly authorized representative of either.

Contracting Officer: The officer in whose name this contract is executed, his successor or successors, his or their duly authorized agent or agents, and any one from time to time designated by the Chief of Ordnance to act as Contracting Officer.

Articles: The articles or things to be furnished under this contract, unless some other articles or things are specifically referred to.

Article II. Articles to be Furnished.—Deliveries and Prices.—The Contractor shall manufacture for and furnish to the United States the articles hereinbelow described, in the number or amount, at the times and at the prices below stated; said articles to comply strictly with the specifications and drawings hereto annexed or referred to below or in Schedule 1 hereto annexed; and the United States shall accept and pay for said articles upon the terms and conditions hereinafter set forth. The workmanship and quality of the articles shall, in the absence of other provisions, be the best of their respective classes and free from latent defects.

Articles: Eight million, seven hundred and sixty thousand (8,760,000) 49 Grain Percussion Primers.

Price: Nine cents ($0.09) for each article or a total of seven hundred and eighty-eight thousand four hundred dollars ($788,400.00) for the entire quantity herein contracted for.

[fol. 185] Deliveries: The delivery of the said articles shall begin on November 1, 1918, and shall continue at the rate of one hundred thousand (100,000) of said articles each day until the entire quantity herein contracted for is delivered. All of said articles shall be delivered before March 2, 1919.

59658°—18.

[fol. 186] Article III. Specifications—The specifications and drawings, if any, hereto annexed or herein referred to, are made a part of this contract with like effect as if herein set out in full. In the event of any conflict between the contract and the specifications or drawings the provisions of the contract shall govern.

From time to time, by written notice to the Contractor, the Contracting Officer may make changes in the specifi-

cations and drawings or supplemental or substituted specifications and drawings. If any such change increases the cost to the Contractor, a fair addition shall be made to its compensation; but if it reduces such cost a fair deduction shall be made therefrom, all as shall be determined by the Chief of Ordnance. No claim for additional compensation hereunder shall be allowed, nor shall the compensation be reduced, unless the change has been ordered in writing. For any delay in delivery attributable to such changes, a corresponding extension of time shall be allowed the Contractor.

Article IV. Component Parts to be Furnished by the United States.—The United States shall furnish without cost to the Contractor the materials and component parts listed on Schedule 2, in quantities determined by the Chief of Ordnance to be requisite for the performance of this contract. Should the Contractor be delayed in making deliveries of the articles by reason of delays in the furnishing of such materials or component parts by the United States, a corresponding extension of time shall be allowed the Contractor.

In addition to the raw materials and component parts listed on Schedule 2, the United States may from time to time, at its option, furnish to the Contractor other materials and component parts for use in the performance of this contract: Provided, however, That the Contractor has not previously and in good faith contracted for the purchase of such materials or component parts. Unless it is provided in writing that materials and component parts (other than those listed on Schedule 2) are furnished by the United States without charge, the United States shall be credited with the value thereof, f. o. b. Contractor's plant, fixed at the estimated cost of such materials or component parts used in determining the contract price of the articles, the Contractor to pay demurrage, storage, cartage, and switching charges. Payments for the articles shall be reduced accordingly.

All materials and component parts furnished by the United States shall comply with specifications and shall remain the property of the United States. The Contractor shall account for all materials and component parts furnished by the United States, the cost of which has not been paid by or deducted from payments made to the Contrac-

tor, in finished product, scrap, unused material or otherwise and shall make such disposition thereof as may be ordered in writing by the Chief of Ordnance. Upon final delivery of the articles, and prior to final payment thereof, the Contractor shall deliver to the Chief of Ordnance a sworn statement, in form satisfactory to him, of the quantity of such unused material or component parts remaining in the Contractor's possession.

Article V. Change in Amounts.—This contract may be considered as completed and so certified by the Chief of Ordnance upon delivery to and acceptance by the United States of the articles, plus or minus 5 per cent thereof. [fol. 187] In the former case there shall be a proportionate increase and in the latter case a proportionate decrease in the total amount payable under this contract.

Article VI. Delivery.—The Articles shall be suitably packed, boxed and marked by the Contractor, as directed from time to time by the Chief of Ordnance, and shall be delivered by the Contractor f. o. b. cars at the railroad station nearest to the place of manufacture, unless some other place of delivery is herein specified. The Contractor shall at the cost of the United States, ship the articles to any point in the United States designated by the Chief of Ordnance.

Article VII. Payment.—The United States shall pay to the Contractor the prices hereinbefore stated for all articles as and when delivered to and accepted by the United States. All payments shall be subject to correction for errors, if any.

Article VIII. Time.—Time is of the essence of this contract. The Contractor shall give the performance hereof preference and priority over any other work except work heretofore given preference or priority by the United States. It shall, from time to time, and whenever requested so to do, furnish the Contracting Officer reports on the progress of the work.

Article IX. Inspection-Rejection.—All materials and component parts unused or in process, the machinery, the equipment and the plant used in the performance of this contract, and the finished articles, shall at all times be subject to inspection by persons designated by the Chief of

Ordnance, and the Contractor shall furnish reasonable facilities and assistance for all such inspection and for testing. Whatever of the materials or component parts not furnished by the United States, or of the articles, do not in all respects comply with the requirements of this contract, shall be rejected, and the decision of the Chief of Ordnance with respect thereto shall be final. The Chief of Ordnance may require the replacement of all rejected materials, component parts, and articles, and the United States may withhold from the payments to be made hereunder an amount sufficient to cover the cost thereof until such replacement. Upon notice from the Contractor that the articles, or any of them, are completed and ready for delivery, final inspection shall be promptly made by the United States.

The process of manufacture shall be at all times subject to the inspection and supervision of the Chief of Ordnance.

Article X. Care of Property.—The Contractor shall use due and proper care to protect all property of the United States in its possession. Such property shall be suitably marked for identification and shall be kept separate and apart from other property.

[fol. 188] Article Xa. Costs under Article XIV shall be determined in accordance with the pamphlet entitled "Definition of 'Cost' Pertaining to Contracts", issued by the office of the Chief of Ordnance, War Department, dated June 27, 1917, made a part hereof by reference.

Article Xb. Upon presentation of the proper certificate of the inspecting and receiving officer of the United States payment under this contract will be made at the unit price herein set forth as each unit is delivered and accepted.

Article Xc. The Contractor, at its own expense, shall suitably pack, box, furnish containers and make such shipping provisions as will insure the arrival of the articles herein contracted for at their destination in as good condition as when accepted by the United States at the plant of the Contractor.

[fol. 189] Article XI. Storage:—The Contractor shall provide at its plant storage capacity sufficient for the storage of ninety (90) days' deliveries of articles at the rate of deliveries herein specified. From time to time, and for so

long as the Chief of Ordnance may require, the Contractor shall safely and adequately store to the extent of such storage capacity any accepted articles which the United States is not ready to have shipped; such storage to be at the risk of the United States but at the cost of the Contractor. By written notice the Chief of Ordnance at any time may require the Contractor promptly to furnish additional storage capacity sufficient to store not more than — days' additional deliveries at said rate. Thereafter from time to time and for so long as the Chief of Ordnance may require the Contractor shall safely and adequately store any accepted articles to the extent of such additional storage capacity, but at the cost and risk of the United States. The additional storage capacity shall be furnished at the Contractor's plant, if practicable, and when that is not practicable, at a place adjacent to or near the plant. Subject to the approval of the Chief of Ordnance such place shall be selected by and the arrangements made therefor by the Contractor. If a portion of the land and buildings then belonging to the Contractor be used for such additional storage, the United States will pay to the Contractor a reasonable rental therefor, to be agreed upon, or, in the absence of an agreement, to be fixed by the Chief of Ordnance.

The articles stored under the provisions of this article after final inspection and acceptance shall be paid for as though they had been delivered f. o. b. cars, but the Contractor shall thereafter, upon the request of the United States and at the expense of the United States, transport the articles stored to the nearest point of shipment by railroad, load the same on cars, and ship the same to such point of destination as the Chief of Ordnance may direct. The United States shall pay to the Contractor all expense incurred for transportation of the articles to storage and cost of unloading and reloading cars at place of storage.

Article XII. Excusable Delays.—The Contractor shall not be held responsible for delays in delivery determined by the Chief of Ordnance to be due to delay in inspection, delay in the giving of shipping instructions to the Contractor, explosions, fires, riots, labor strikes, acts of war, acts of God, or to any other causes beyond the control of the contractor. The Contractor shall use its best efforts to remove such cause of delay as speedily as possible, and

immediately upon the removal thereof shall proceed with the performance of this contract. The time for the making of deliveries shall be extended by the period of such delay, provided application therefor be made in writing within thirty (30) days after the removal of such cause for delay. Where, however, such delays have been substantial and not due to any act or omission of the United States, the Chief of Ordnance shall have the option either to cancel this contract or any of the deliveries that have been delayed upon the terms set forth in Article XIV hereof or to permit the Contractor to proceed with the performance of the contract.

[fol. 190] Article XIII. Breach by Contractor.—If the Contractor shall abandon this contract or shall violate any material provision thereof, or shall fail at any time to prosecute with diligence the manufacture of the articles or the performance of this contract or if this contract shall be assigned, the Chief of Ordnance may, without prejudice to any other rights or remedies or to any claim which the United States may have, terminate this contract by written notice and complete the performance hereof or enter into agreements with other parties for the completion of the performance hereof in whole or in part or purchase in the open market or otherwise any articles remaining undelivered hereunder; and the Contractor shall pay to the United States all loss and damage incurred as a result of such action.

Article XIV. Termination.—This contract being necessitated by a state of war now existing, it is desirable and expedient that provision be made for its cancellation upon fair and equitable terms in the event of the termination or limitation of the war, or if in anticipation thereof or because of changes in methods of warfare the Chief of Ordnance should be of the opinion that the completion of this contract has become unnecessary. It is therefore provided that at any time, and from time to time, during the currency of this contract, the Chief of Ordnance may for any of the causes above stated notify the Contractor that any part or parts of the articles then remaining undelivered shall not be manufactured or delivered.

In the event of such complete or partial termination the United States shall inspect all completed articles then on hand and such as may be completed within thirty (30) days

after such notice, and shall pay to the Contractor the price herein fixed for all articles accepted by and delivered to the United States. The United States shall also pay to the Contractor the cost of the materials and component parts purchased by the Contractor for the performance of this contract and then on hand in an amount not exceeding the requirements for the completion of this contract provided they comply with the specifications, and also all costs shown by the Contractor to have been theretofore necessarily incurred in the performance of this contract and remaining unpaid; and the United States shall also protect the Contractor on all obligations incurred necessarily and solely for the performance of this contract of which the Contractor cannot be otherwise relieved. To the above may be added such sums as the Chief of Ordnance may deem necessary to fairly and justly compensate the Contractor for work, labor and service rendered under this contract.

Title to all such materials and component parts paid for by the United States under this article shall, immediately upon such payment, vest in the United States.

[fol. 191] The United States may refuse to make any payment or to reimburse the Contractor for or on account of material or component parts intended to form a part of the articles, whether unused or in the process of manufacture or manufactured, in respect of the delivery of which the Contractor shall be in arrears not due to causes beyond its control at the time of such termination.

Article XV. Precautionary Measures.—In addition to the ordinary precautions heretofore adopted by the Contractor for the guarding and protection of its plant and work, the Contractor shall provide such additional watchmen and devices for protection of its plants and property and the work in process for the United States against espionage, acts of war, and of enemy aliens as may be required by the Chief of Ordnance. The Contractor shall, when required, report to the Chief of Ordnance, the citizenship, country of birth, or alien status of any and all of its employees. When required by the Chief of Ordnance the Contractor shall refuse to employ, or if already employed, forthwith discharge from employment and exclude from its works any person or persons designated by the Chief of Ordnance for cause as undesirable for employ-

ment in a plant engaged on work for the United States. The United States shall pay to the Contractor as part of the cost of the articles any expense incurred by the Contractor which shall be determined by the Chief of Ordnance to be directly caused by the requirements of this article.

Article XVI. Exploitation Forbidden.—The Contractor agrees to refrain from exploiting by publicity or otherwise its products manufactured in pursuance of this contract, and of any and *and* all contracts and orders heretofore or hereinafter entered into or placed with the Contractor, and its products manufactured under any arrangements with the United States whatsoever, and the Contractor agrees to refrain from in any way publicly advertising the fact of the manufacture of said product, and to refrain from publishing or causing or allowing to be published any photographs, drawings, written or printed matter, or other data disclosing the articles, or parts of the same, or the process of manufacture, or the plans of the Government, or any information concerning the same or which shall result in such disclosure. The Contractor agrees to submit to the Chief of Ordnance all pictures or printed matter showing, describing, or in any way relating to the progress of the work to be prosecuted under this contract and under any and all contracts and orders heretofore or hereafter entered into or placed with the Contractor, or under any arrangements with the United States whatsoever, which he may desire to publish, before publishing the same, and the Chief of Ordnance may prohibit such publication. The Contractor further agrees to refrain from giving any information whatsoever relative to any experiments that may be carried out by it at the instance of the United States.

Article XVII. Contract not Assignable.—The Contractor shall not assign, transfer, or otherwise dispose of this contract or any part thereof without the written consent of the Secretary of War, nor shall it assign any moneys due or to become due hereunder.

Article XVIII. Subcontracts.—The Contractor shall insert in every contract hereafter made in relation to the performance of this contract, a provision that such contract may be assigned by the Contractor and that it relates to this contract. The Contractor shall, from time to time,

upon request, exhibit to the Contracting Officer any and all [fol. 192] contracts made in connection with the performance of this contract.

Article XIX. Waiver of Liens.—The Contractor hereby waives and releases all lien or right of lien now existing or that may hereafter arise for work or labor performed or materials furnished or for any other reason or cause under this contract, under any lien laws, State or Federal, upon any component parts, materials, supplies, and the like coming into its possession, which it is herein contemplated shall presently or ultimately become the property of the United States, and the Contractor agrees not to create or suffer to be created any mortgage, lien, pledge, attachment, or other encumbrance upon any such component parts, material, supplies, or other property in its possession intended to form a part of the articles to be delivered under this contract. In the event that such mortgage, pledge, lien, attachment, or encumbrance is created, the Contractor agrees to pay and discharge, or if it disputes the validity of the claim out of which such encumbrance arises, immediately to bond same to the end that all property shall at all times be and remain free from all encumbrances.

Article XX. Disputes.—Except as herein otherwise specifically provided, any doubts or disputes which may arise under this contract or as to its performance or nonperformance shall be referred to the Chief of Ordnance for determination. If the Contractor shall feel aggrieved at his decision, it shall have the right of appeal to the Secretary of War, whose decisions shall be final.

Article XXI. Patents.—The Contractor hereby covenants and agrees to hold and save the United States and all persons acting under them harmless from and against all and every demand or demands of any nature or kind for or on account of the adoption of any plan, model, design, or suggestion or for or on account of the use of any patented invention, article, or appliance that has been or may be adopted or used in or about the construction of said articles, or any part thereof, under this contract, and to protect and discharge the United States from all liability on account thereof, or on account of the use thereof, by proper releases from the patentees, and by bond if re-

quired, or otherwise, and to the satisfaction of the Chief of Ordnance.

Article XXII. Notice.—Any notice addressed to the Contractor at its principal office and either there delivered or deposited in a postpaid wrapper in any post-office box regularly maintained by the United States, shall be deemed to have been served upon the Contractor. The address of the Contractor may be changed at any time by notice in writing to the Contracting Officer. Nothing herein contained shall preclude service of notices upon the Contractor (1) where it is a corporation by delivery thereof to any of its officers or directors in person; (2) where it is a firm by delivery thereof to one of the partners; (3) where it is an individual by delivery thereof to him in person.

Article XXIII. Officials Not to Benefit.—No Member of or Delegate to Congress or Resident Commissioner is or shall be admitted to any share or part of this contract or to any benefit that may arise therefrom; but this article shall not apply to this contract so far as it may be within the operation or exception of section 116 of the act of Congress approved March 4, 1909 (35 Stats., 1109).

Article XXIV. Prison Labor.—No person or persons shall be employed in the performance of this contract who are undergoing sentences of imprisonment at hard labor which have been imposed by the courts of the several States, Territories, or municipalities having criminal jurisdiction.

[fol. 193] In witness whereof the parties hereto have caused this contract to be duly executed in triplicate by their respective officers, thereunto duly authorized, the day and year first above written.

Signatures: (Sgd.) United States Cartridge Co., by C. E. Hoxie, Agent, Contractor. United States of America, by (Sgd.) R. P. Lamont, Lt. Col. Ord. N. A., Contracting Officer.

Witnesses: (Sgd.) H. A. Smith. (Sgd.) Bessie M. Holland.

[fol. 194] Schedule 1 attached to and a part of a certain contract between the United States of America and United States Cartridge Company, and dated the 20th day of July, 1918.

Each and every of the pamphlets, drawings, specifications, and other papers enumerated is made a part of the schedule and of the contract of which this schedule is a part.

Specifications: Ordnance Department Specification GA 144-1 approved February 5, 1918.

Drawings: Ordnance Office Drawing 74-2-18 last revised January 25, 1918.

[fol. 195] Schedule 2 attached to and a part of a certain contract between the United States and United States Cartridge Company and dated the 20th day of July, 1918.

Seventy-five (75) pounds of high grade copper and forty (40) pounds of Grade "A" spelter for every one thousand (1000) Primers herein contracted for.

War Department, Office of the Chief of Ordnance.

Form No. 601. Ed. May 13-18-203,000. Washington: Government Printing Office: 1918.

[fol. 196] EXHIBIT 14

GA-126. GA 471,835, 66 Enc. 2

United States Cartridge Co. and United States of America

Ordnance Department, U. S. Army

Fixed Price Contract

5,000,000 110-grain percussion primers for 3-inch cartridge cases.

Dated August 22, 1917.

Expires March 31, 1918.

These Articles of Agreement entered into this 22d day of August, 1917, by and between the United States Cartridge Company, a corporation organized and existing under and by virtue of the laws of the State of Massachusetts, and

having its general office at Lowell, Mass. (hereinafter called the Contractor), of the first part, and the United States of America, by Jay E. Hoffer, colonel, Ordnance Department, United States Army (hereinafter called the Contracting Officer), acting by and under the authority of the Chief of Ordnance, United States Army, and under the direction of the Secretary of War, of the second part;

Witnesseth:

Whereas a state of war exists between the United States of America and the Imperial German Government, constituting a national emergency,

Now, Therefore, under the provisions of section 120 of [fol. 197] an act of Congress relating to national defense, approved June 3, 1916, and pursuant to all other laws of the United States and Executive Orders of the President of the United States or heads of its departments under which the requirements of advertisement for proposals are dispensed with, and contracts in the form hereof duly authorized, and in consideration of the mutual agreements herein contained, the said parties have agreed and by these presents do agree to and with each other as follows: viz:

Article I

The Contractor agrees to make and deliver to the United States 5,000,000 110-grain percussion primers for 3-inch cartridge cases (hereinafter called the articles), each of the articles being referred to as a unit, in accordance with the drawings and specifications referred to in Schedule 1 hereto attached and made a part hereof, and such changes as may be made therein as hereinafter provided, and the United States agrees to pay therefor, all upon the terms and conditions in this contract set forth.

Article II

The Contractor agrees to deliver the articles to the United States f. o. b. cars at Lowell, Mass., as follows:

During the month of August, 1917, 1,000,000 primers.
During the month of September, 1917, 1,500,000 primers.
During the month of October, 1917, 1,500,000 primers.
During the month of November, 1917, 1,000,000 primers.

Time being of the essence, the Contractor undertakes to

increase the production to such a maximum rate as facilities and equipment permit, and the Contractor will use his best endeavors to complete the performance of this contract at an earlier date than herein fixed, anticipating deliveries in [fol. 198] so far as possible. The performance of this contract shall have precedence over all work for parties other than the United States. The Contractor will, from time to time and whenever requested so to do by the Contracting Officer, furnish to the Contracting Officer statements and reports on the progress of the work and any factors bearing on deliveries.

The Contractor will not be held responsible for delays in delivery due to the delay of the United States in furnishing any material to be supplied by the United States, or by other delays due to causes beyond the control of the Contractor, such as riots, labor strikes, acts of war, and the like, but simultaneously with the removal of such cause for delay the Contractor shall proceed with the performance of this contract, due allowance for such delay having been made. The Contractor agrees, in view of the emergency necessitating this contract to use its best endeavors to remove such cause for delay.

Deliveries—Storage.—Deliveries of accepted articles shall be made to the inspecting and receiving officer designated by the Contracting Officer, at the plant of the Contractor f. o. b. cars at Lowell, Mass., but the Contractor shall safely and adequately store the articles, after acceptance, at the risk of the United States, for a reasonable time thereafter, without charge. Should the Contracting Officer direct the storage of the accepted articles for a prolonged period, the Contractor shall safely and adequately store the articles at the cost and risk of the United States for as long a period as the Contracting Officer shall deem necessary.

If land and buildings then belonging to the Contractor are used for storage, the United States will pay to the Contractor a reasonable rental therefor as may be mutually [fol. 199] agreed upon, or if agreement is impossible, as may be fixed by the Chief of Ordnance, in no event, however, to exceed — (10) per cent per annum of the cost of such land and buildings to the Contractor or the proportion of such cost according to the proportion of the land and buildings so used.

Packing and Shipping.—The Contractor at its own expense shall suitably pack, box, mark the articles, and load the same on cars either before or after storage, and at the cost of the United States shall ship the articles to any point in the United States, making all arrangements for transportation, all according to the instructions of the Contracting Officer.

Article III

Purchase Price.—The sum of $0.12 is hereby fixed as the purchase price of each unit, delivered and accepted, subject, however, to adjustments covering variations of prices of materials as hereinafter provided. The purchase price per unit above is based on copper at 32 cents per pound and spelter at 16 cents per pound, delivered at Contractor's plant.

It is agreed that for all variations from the above prices of copper and spelter, whether upward or downward, a corresponding adjustment will be made in the purchase price of $0.12 for each unit, it being the intention of this contract that the Contractor shall neither profit nor lose by any fluctuation in the prices of copper and spelter.

Payments.—The purchase price above fixed for each unit will be paid by the United States to the Contractor as follows:

(1) A sum equal to eighty per cent (80%) of the actual cost to the Contractor of material delivered in quantities requisite for the due and timely completion of this contract, purchased by the Contractor and delivered at the Contractor's plant, shall be paid to the Contractor as soon as practicable after the first of the month for all deliveries [fol. 200] during the preceding month or months. The payment provided for herein will be made upon the certificate of the Contracting Officer or his duly accredited representative that such material has been delivered to the Contractor and inspected and approved by him. Payments under this subdivision shall in no event be for copper in excess of 457,125 pounds and for spelter in excess of 205,375 pounds.

The Contractor shall not purchase or contract to purchase any material to be used in the performance of this

contract without first obtaining the approval of the Contracting Officer thereof. All material and the articles shall be subject to inspection and approval by the Contracting Officer or his duly accredited representative, and whatever thereof does not in all respects fulfill the requirements of the contract shall be rejected, and the decision of the Contracting Officer or his duly accredited representative as to the quantity and quality thereof shall be final. The Contractor agrees to immediately replace, without cost to the United States, all material so rejected. The Contracting Officer may withhold out of payments to be made hereunder on any account an amount sufficient to cover the cost thereof, until proper replacement of rejected material and primers.

Title to Vest in the United States.—The title to all such material shall vest in the United States simultaneously with any payment on account thereof by the United States, subject, however, to rejection of title at any time by the inspecting and receiving officer if found not to meet specification requirements. All of such material shall, immediately upon its coming into possession of the Contractor, be marked for the purpose of identification as the Contracting Officer shall so direct.

(2) Upon the certificate of the inspecting and receiving officer, showing delivery and acceptance, the United States will pay the difference* between the amount per unit paid, to the Contractor under subdivision 1 of this article on [fol. 201] account of materials and component parts and 95 per cent ($0.114) of the contract price for the articles adjusted to actual cost of materials and component parts as soon as practicable after the first of the month for each unit delivered and accepted during the previous month or months.

(3) Upon the completion of the contract duly certified to by the Contracting Officer, the United States will pay, sub-

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*If the Contractor has taken full advantage of the provisions of subdivision 1 of this article, it will have been paid thereunder the sum of $0.0286624 per unit adjusted to actual cost of material, and under subdivision 2 it will therefore be entitled to receive the sum of $0.0853376 per unit adjusted to actual cost of materials per unit.

ject to additions or deductions necessary to proper adjustment, the remainder of the unpaid purchase price of each unit delivered and accepted during the life of this contract.

Prompt Payments.—To facilitate prompt payments the United States may attach a paymaster to the main office or plant of the Contractor. No payments by the United States shall act to prevent the United States from later disputing the validity thereof, under this contract.

Any lot of primers which the Contractor may be directed to put into storage pursuant to the provisions hereof, after final inspection and acceptance, shall, for the purpose of payment, be deemed to be delivered and the Contractor shall be entitled to be paid therefor as if delivered f. o. b. cars at Lowell, Mass.

United States May Furnish Materials.—The United States may, from time to time, furnish the Contractor with material needed in the performance of this contract: Provided, however, That the Contractor's undertakings therefor previously made in good faith are not interfered with. Such material shall be accepted by the Contractor at the prices set forth in the schedule of materials contained herein, and the price to be paid by the United States [fol. 202] for the articles, as herein set forth, shall be reduced by an amount equal to the total of such prices of materials so furnished by the United States.

It is agreed that all material furnished by the United States shall be in accordance with the requirements under the specifications.

Article IV

Plant, etc., May be Inspected.—All material furnished under this contract, the plant, machinery, tools, and equipment, all workmanship, the articles, and all bills, statements, receipts, vouchers, books, correspondence, memoranda, and other records of all sorts of the Contractor in any way related to the subject of this contract shall be at all times subject to inspection by the officers or agents of the Ordnance Department or persons designated by the Chief of Ordnance or the Contracting Officer, and the Contractor shall furnish reasonable facilities and assistance for all such inspection. The Contractor shall keep all such

records convenient for ready reference and shall preserve the same for a period of at least six years after the completion of the contract.

Article V

Change of Drawings, Specifications, etc.—It is agreed that the Contracting Officer may, by written notice to the Contractor at any time, make changes in the drawings and specifications or supplemental or substituted drawings and specifications which relate to, form a part of, or are added to this contract, or in the provisions whereby the United States undertakes to furnish materials. If such changes involve substantially additional work for the Contractor's manufacturing organization or labor and material, a fair [fol. 203] addition will be made to the purchase price, but if such changes involve substantially less of such work, or labor and material, a fair deduction may be made therefrom, all as shall be determined by the Contracting Officer. No claim for addition or deduction on account of any such change will be made or allowed unless the same has been ordered in writing.

Article VI

Contractor Shall Hold Facilities in Readiness for Additional Order.—The United States shall have the right to order at any time before the completion of this contract and thereupon the Contractor shall supply, any additional articles as may be required upon such terms as are fair and just. If the Contracting Officer and the Contractor are unable to agree upon such terms, the matter shall be submitted to the Secretary of War, whose decision shall be final. Pending such notice by the United States, the Contractor agrees to accept no order for work of any description to be executed with any of the facilities used in the performance of this contract without the written consent of the Contracting Officer, and shall and will remain ready to take any such additional order from the United States and shall give the performance thereof precedence over work for all parties other than the United States; or again the United States may, with the consent of the Contractor, accept in full satisfaction of this contract such lesser quan-

tities of the articles than the amount herein definitely contracted for as the Contracting Officer may designate.

Article VII

Termination.—In the event of failure or probable failure of the Contractor to comply with the terms of this contract or any of them, or in the event that the Chief of Ordnance is of the opinion that public interest so re- [fol. 204] quire, this contract may be terminated by notice in writing to the Contractor without prejudice to any claim the United States may have against the Contractor. Thereupon the Contracting Officer, with the approval of the Chief of Ordnance, may proceed to complete the making and delivery of the articles herein contracted for, or any part thereof, as well as any additional articles, and may employ such agents and employees, including the Contractor, its agents and employees, as the Contracting Officer may deem necessary or desirable, and may take possession of the plants and property of the Contractor used in the performance of this contract, secure from the Contractor an assignment of all contracts and agreements relating to this contract, which said contracts and agreements the Contractor hereby agrees to assign, and may generally do and perform all acts and things necessary or convenient in order to obtain the articles which are the subject of this contract, all of which is agreed to by the Contractor. In the event of the termination of this contract, the United States will inspect the completed articles whether in lots of 25,000 or otherwise, then on hand, and will pay to the Contractor the price herein agreed upon, subject to proper adjustment, for each and every of such completed articles accepted by and delivered to the United States.

To the extent that the United States takes over the plant and property of the Contractor for the completion of this contract or for he manufacture of additional articles, the United States will pay a reasonable rental therefor for the term of occupation, as may be mutually agreed upon between the Contracting Officer and the Contractor; or if agreement is impossible, as may be fixed by the Chief of Ordnance as reasonable rental. Such manufacture by the United States shall always be conducted without expense

of any sort to the Contractor except as to the contrary else-
[fol. 205] where provided.

In the event of the termination of this contract without any default by the Contractor, the United States will pay to the Contractor the cost of the material on hand in an amount not exceeding the requirements for the completion of this contract which shall be in accordance with the specifications referred to in Schedule 1 hereto attached, and also all costs theretofore expended and for which payment has not been previously made, and all obligations incurred solely for the performance of this contract, together with a sum equivalent to ten (10) per cent of all such costs so expended, except that said ten (10) per cent shall not apply on the cost of purchased component parts and material, raw and not in process of conversion, and on costs of material and component parts furnished by the United States. The ten (10) per cent of cost herein allowed shall be subject to such addition or deduction as the Contracting Officer may deem necessary to fairly and justly compensate the Contractor for the work, labor, and services rendered under this contract.

In the event that upon the termination of this contract by reason of the default of the Contractor as aforesaid, the United States takes over the plant and property of the Contractor for the completion of this contract or for the manufacture of additional articles, the United States will pay to the Contractor in addition to the reasonable rental as above provided, the cost of material on hand in an amount not exceeding the requirements for the completion of this contract which will be in accordance with the specifications referred to in Schedule 1 hereto attached.

Title to all materials paid for under this article by the United States shall, immediately upon such payment, vest in the United States.

[fol. 206] The decision of the Contracting Officer as to payments and allowances to the Contractor under this article made in accordance with the terms of this contract and with Schedule 2, made a part hereof, will be final.

Open Market Purchase to Complete Contract.—In the event of the termination of this contract by reason of the failure of the Contractor to prosecute properly at any time the manufacture of the articles herein contracted for

or to deliver the articles as provided in Article II of this contract, the Contracting Officer may, with the approval of the Chief of Ordnance after notification to the Contractor in writing, in lieu of undertaking the completion of this contract by the operation of Contractor's plant, procure any or all of the articles then remaining to be delivered under this contract in the open market or in such other manner as the Contracting Officer may deem best for the interests of public service. The Contractor shall be charged the amount, if any, by which the cost to the United States resulting from such action shall exceed the sum of $0.12 adjusted to actual price of copper and spelter for each article so procured.

In the event of the termination of this contract as aforesaid without any default by the Contractor, the United States will pay to the Contractor all cost to date as allowed and determined by the Contracting Officer in accordance with the terms and provisions of this Contract, and with the statement attached hereto, made a part hereof and marked "Schedule 2," and in addition thereto a sum equivalent to 10 per cent of all such costs (except the cost of purchased material, raw, and not in process of conversion; and except the materials and other property furnished by the United States), less all payments previously made in accordance with Article III.

[fol. 207] The foregoing provisions with regard to payments to be made by the United States upon the termination of this contract shall also apply in the event that the performance by the Contractor of this contract is prevented by acts of war, riots, incendiarism, or other causes beyond the control and without the fault of the Contractor which may be directly traceable to the United States being in a state of war, without, however, relieving the Contractor from further performance whenever the effect of such causes shall be removed.

In the event of the termination of this contract as aforesaid, any and all obligations of the United States to make any payments to the Contractor hereunder other than those specified in this Article VII, shall at once cease and determine. The United States shall receive credit for all payments made to the Contractor prior to the termination of this contract, and if such payments shall exceed the amount payable under this article, the Contractor shall immedi-

ately repay the amount of such excess to the United States, but if such payments shall be less than the amount payable under this Article, the United States will pay to the Contractor the amount of such difference upon the proper certificate of the Contracting Officer.

Article VIII

Materials, etc., to be Kept Unincumbered.—The Contractor hereby, for the consideration herein named, waives and releases all lien or right of lien now existing or that may hereafter arise for work or labor performed or materials furnished or for any other reason or cause under this contract, under any lien law, State or Federal, upon any component parts, materials, supplies, and the like coming into its possession which it is herein contemplated shall presently or ultimately become the property of the [fol. 208] United States, and the Contractor agrees not to create or suffer to be created any mortgage, lien, pledge, attachment, or other incumbrances upon any such component parts, material, supplies, or other property in its possession, and in the event that such mortgage, pledge, lien, attachment, or incumbrance is created the Contractor agrees to pay and discharge, or if it disputes the validity of the claim out of which such incumbrance arises, immediately to bond the same, to the end that all property shall at all times be and remain free from all incumbrance.

Article IX

This Contract not Assignable.—This contract shall not, nor shall any right to receive payment or any other interest therein, be transferred or assigned by the Contractor to any person, firm, or corporation, without the consent of the Secretary of War.

Subcontracts.—The Contractor shall make all subcontracts, purchases, payments, and arrangements for performing this contract in its own name and for its own account and shall not bind or purport to bind the United States except as the Contracting Officer shall otherwise direct in writing.

Subcontracts Must be Assignable and Refer to This Contract.—The Contractor shall, unless otherwise directed by the Contracting Officer, insert in every contract hereafter made for increased facilities, component parts, labor, ma-

terial, supplies, and the like, or otherwise relating to the performance of this contract, a provision that such contract may be assigned by the Contractor and that it relates to a "main contract" between the Contractor and the United States.

Article X

Eight-hour Day.—No laborer or mechanic doing any part [fol. 209] of the work contemplated by this contract, in the employ of the Contractor, or any subcontractor contracting for any part of said work contemplated, shall be required or be permitted to work more than eight hours in any one calendar day upon such work, such prohibition being in accordance with the act approved June 19, 1912, limiting the hours of daily service of mechanics and laborers on work under contracts to which the United States is a party. For each violation of the requirements of this article a penalty of $5 shall be imposed upon the Contractor for each laborer or mechanic for every calendar day in which said employee is required or permitted to labor more than eight hours upon said work, and all penalties thus imposed shall be withheld for the use and benefit of the United States: Provided, That this article shall not be enforced nor shall any penalty be enacted in case such violation shall occur while there is in effect any Executive Order suspending the provision of said act approved June 19, 1912, or waiving the provisions and stipulations thereof with respect to either this contract or any class of contracts in which this contract shall be included, or when the violation was due to any extraordinary event or conditions of manufacture, or to any emergency caused by fire, famine, or flood, by danger to life or property, or by other extraordinary conditions on account of which, by subsequent Executive Order, such past violation shall have been excused.

Naval Appropriation Act—Executive Order.—It is agreed that the Contractor doing any part of the work contemplated by this Contract, and any subcontractor contracting for any part of said work, shall comply with the provisions of the naval appropriation act approved March 4, 1917, and the Executive Order of the President dated March 24, 1917, in respect to wages of persons employed [fol. 210] upon contracts with the United States, in so far

as such provisions may be applicable thereto, so long as said Act approved March 4, 1917, and said Executive Order, dated March 24, 1917, shall be in force and effect.

Article XI

Labor Disputes.—In the event that labor disputes shall arise directly affecting the performance of this Contract, and causing or likely to cause any delay in making the deliveries upon the date or dates specified, the Contractor shall address a written statement thereof to the Chief of Ordnance for transmission to the Secretary of War with the request that such dispute be settled, providing such information and access to information within the control of the Contractor as the Secretary of War shall require, and it is stipulated and agreed that the Secretary of War may thereupon settle or cause to be settled such dispute, and the Contractor agrees to accede to and comply with all the terms of such settlement. If the Contractor is thereby required to pay labor costs higher than those then prevailing in the performance of this contract prior to such settlement a fair addition to the contract price of the articles shall be made therefor; but if such settlement reduces the labor cost to the Contractor, a fair deduction shall be made from the contract price, all as may be determined by the Contracting Officer. No claim for addition or deduction shall be made unless the same has been ordered in writing.

Article XII

Officials Not to Benefit.—No member or Delegate to Congress or Resident Commissioner, nor any person belonging to or employed in the military service of the United States, is or shall be admitted to any share or part of this contract [fol. 211] or to any benefit that may arise therefrom; but this article shall not apply to this contract so far as it may be within the operation or exception of section 116 of the act of Congress approved March 4, 1909 (35 Stats., 1109).

Article XIII

Prison Labor.—No person or persons shall be employed in the performance of this contract who are undergoing sentences of imprisonment at hard labor which have been

imposed by the courts of the several States, Territories, or municipalities having criminal jurisdiction.

Article XIV

Disputes to be Referred to Chief of Ordnance.—The decision of the Contracting Officer on all questions of prices and the allowance and the payment thereof shall be final, except that either, upon the completion of the contract by the Contractor or its termination by the United States, or whenever claims amounting in the aggregate to $75,000 shall have been disallowed or determined adversely to the Contractor by the Contracting Officer, the Contractor may appeal to the Chief of Ordnance by filing one statement of claims (in quintuplicate), which shall embrace all claims previously disallowed or determined adversely, provided all such claims shall be certified by the Contracting Officer or his duly authorized representative as being in their entirety the subject of expenditure of or cost to the Contractor. The decision of the Chief of Ordnance shall be final on such an appeal.

Except as this contract shall otherwise provide, any doubts or disputes which may arise as to the meaning of anything in this contract shall be referred to the Chief of Ordnance for determination. If, however, the Contractor [fol. 212] shall feel aggrieved at any decision of the Chief of Ordnance upon such reference, he shall have the right to submit the same to the Secretary of War, whose decision shall be final.

But nothing in this contract contained shall be construed in prejudice of any rights and privileges the Contractor may have to bring an action in the Court of Claims or any other proper tribunal; nor shall anything herein be construed as the consent of the United States or any Officer to such an action as a waiver of any rights or defenses the United States may have with respect thereto.

Article XV

Bond.—The Contractor shall furnish to the United States within 10 days after the execution and delivery of this agreement a bond in the sum of $60,000, conditioned upon the full and faithful performance by the Contractor

of all terms, covenants, and conditions of this agreement on the part of the Contractor to be performed. Such bond shall be in the form and with sureties satisfactory to the Contracting Officer. Unless such bond is furnished within the time limited, this agreement may, at the option of the Contracting Officer, be canceled.

Article XVI

Notice.—Notice under this contract when not actually given to the Contractor shall be deemed to have been sufficiently given to and received by the Contractor when mailed in a sealed postpaid wrapper addressed to the United States Cartridge Company, Lowell, Mass.

Article XVII

This contract may be executed in any number of counterparts, all of which together shall constitute one original contract. Wherever the term "Contracting Officer" is [fol. 213] used in this contract the same shall be construed to mean his successor or successors, his duly authorized agent or agents, or any one designated by the Chief of Ordnance, from time to time, to act as Contracting Officer.

In Witness Whereof the parties hereto have caused this contract to be executed (in quintuplicate) by their respective officer, duly authorized, the day and year first above written.

(Change on pages 4 and 11, made before execution.)

Signatures: (Sgd.) United States Cartridge Company, Contractor, by C. E. Hoxie, Agent. (Sgd.) United States of America. Jay E. Hoffer, Colonel, Ordnance Department, U. S. Army, Contracting Officer.

Witnesses: (Sgd.) Lena A. Monroe. (Sgd.) H. A. Smith, (Sgd.) by W. S. Clarke.

Schedule 1 attached to and a Part of a Certain Contract between the United States Cartridge Company and the United States of America, and Dated the 22d Day of August, 1917.

5,000,000 110-Grain Percussion Primers for 3-inch cases.

Each and every of the pamphlets, drawings, specifica-

tions, and other papers below enumerated is made a part of this schedule and of the contract of which this schedule is a part.

Request for proposals dated May 3, 1917 (0.0.471.-823/21), in accordance with Ordnance Department Form 3010, dated April 14, 1917, and in accordance with Ordnance Office drawings, Class 74, division 2, drawing 3, last revised June 15, 1917; Class 76, division 8, drawing 3, last revised July 1, 1914; Class 76, division 8, drawing 9, dated Sept. 2, 1914.

Proposal dated May 8, 1917 (0.0.471.835/22-encl. 1), for [fol. 214] 5,000,000, more or less, 110-Grain Percussion Primers.

Schedule 2 Attached to and a Part of a Certain Contract between the United States Cartridge Company and the United States of America, and Dated the 22d Day of August, 1917.

Detail of Cost Accounting

The term "cost" as applied to this contract consists of four elements which are concretely defined in the following:

(1) The cost of all direct labor paid for by the Contractor and used in the production of the articles contracted for herein.

(2) The cost of all direct materials contained in or forming part of the articles contracted for herein.

(3) Pro rata share of factory overhead expenses applicable to and necessary in connection with the manufacture of the articles contracted for herein.

(4) Pro rata share of administrative and general expense applicable to and necessary in connection with the manufacture of the articles contracted for herein.

The foregoing paragraphs Nos. 1, 2, 3, and 4 are subject to further amplification as contained in the "Definition of cost pertaining to contracts" to be supplied by the Finance Division (Accounting Section) of the Ordnance Department. As conditions arise necessitating changes or modifications in the definitions referred to, the Contracting Of-

ficer will furnish the Contractor with information in regard thereto.

[fol. 215] EXHIBIT 15

War Department, Purchase Section, Gun Division

Office of the Chief of Ordnance, 1330 F Street, Washington

November 15, 1917.

In replying refer to No. War-Ord-Ga126, File Sym. GPF.

United States Cartridge Co., Lowell, Mass.

GENTLEMEN:

Subject: Modification of order for five million ($5,000,000), more or less, 110-grain percussion primers.

1. Referring to the order placed with you under date of June 29, 1917 (Order No. War-Ord-Ga 126) for five million (5,000,000), more or less, 110-grain percussion primers, I am directed by the Chief of Ordnance to inform you that paragraph 4 of said order is hereby modified to read as follows:

"4. The price to be paid you for these primers is Thirteen and Eight-Tenths (13.8) Cents each."

2. This additional price of One and Eight-Tenths (1.8) cents per primer is allowed in view of the expense incurred by you due to the change from the 110-grain primer to the 75 m/m primer, and the consequent interruption in their production.

Respectfully, (Sgd.) Jay E. Hoffer, Colonel, Ord. Dept., U. S. Army.

[fol. 216] Purchase Section, Gun Division, Ordnance Office, War Department, 621 G Street, Washington, D. C.:

You are advised that this company hereby accepts this modification of Order No. WAR-ORD-GA-126 as per the above letter.

Date: —— —, ——.

———— ——.

(To be signed and returned to the Purchase Section, Gun Div.)

[fol. 217] EXHIBIT 16

File G. A.-126

November Twenty-eight, 1917.

Purchase Section, Gun Division, Office of the Chief of Ordnance, U. S. Army, 1330 F St. N. W., Washington, D. C.

GENTLEMEN: Replying to your letter of Nov. 26th. Modification of Procurement Order GA-126, we herewith acknowledge receipt and accept same for 5,000,000 more or less 110 grain Percussion Primers. Price to be changed to 13.8 cts., each.

Very truly yours, (Sgd.) U. S. Cartridge Company.
C. E. Hoxie, Agent.

[fol. 218] EXHIBIT 17

Proc. Req. No. 2158. P-Work-Order 5745-57410. Duplicate

The United States of America and United States Cartridge Company

War Department, Office of the Chief of Ordnance, Procurement Division

Contract for Unprimed 110-Grain Primer Bodies

Quantity: 1,000,000.
Price: $0.09 each. Total: $90,000.00.
Dated July 25, 1918.
Expires: —— —, ——.

All communications referring to this Contract should be addressed in accordance with directions contained in the current issue of "Instructions to Contractors," issued by this Department, and should refer to File No. P, War-Ord-P12621-3124A.

(Seal Ordnance Department.)

Washington, Government Printing Office, 1918

[fol. 219] This agreement made this 25th day of July, 1918, between United States Cartridge Company, a cor-

poration organized and existing under and by virtue of the laws of the State of Massachusetts and having an office at Lowell, Massachusetts, party of the first part, and the United States of America, by R. P. Lamont, Lt. Col. Ord. N. A. National Army, acting by direction of the Chief of Ordnance, United States Army, and under the authority of the Secretary of War, party of the second part,

Witnesseth:

Whereas a state of war exists between the United States and certain foreign countries, constituting a national emergency, and the usual requirements of advertisement for bids are dispensed with,

Now, therefore, the parties hereto, in consideration of the mutual agreements herein contained have agreed and do hereby agree with each other as follows:

Article I. Definitions.—Whenever in this contract the words hereinafter enumerated are used, they shall mean what is set opposite them:

Contractor: The party of the first part and its legal representatives, successors and assigns.

Chief of Ordnance: The Chief of Ordnance, the Acting Chief of Ordnance, or any duly authorized representative of either.

Contracting Officer: The officer in whose name this contract is executed, his successor or successors, his or their duly authorized agent or agents, and any one from time to time designated by the Chief of Ordnance to act as Contracting Officer.

Articles: The articles or things to be furnished under this contract, unless some other articles or things are specifically referred to.

Article II. Articles to be Furnished—Deliveries and Prices.—The Contractor shall manufacture for and furnish to the United States the articles hereinbelow described, in the number or amount, at the times and at the prices below stated; said articles to comply strictly with the specifications and drawings hereto annexed or referred to below or in Schedule 1 hereto annexed; and the United States shall accept and pay for said articles upon the terms and conditions hereinafter set forth. The workmanship and quality of the articles shall, in the absence of other pro-

visions, be the best of their respective classes and free from latent defects.

Articles: One million (1,000,000) Unprimed 110-Grain Primer Bodies.

Price: Nine cents ($0.09) for each article boxed, or a total of Ninety thousand dollars ($90,000.00) for all of the articles herein contracted for f. o. b. Contractor's Plant, Lowell, Massachusetts.

Deliveries: The delivery of the articles shall commence August 1, 1918, and shall continue at the rate of 100,000 articles each month thereafter until all of the articles have been delivered. All deliveries shall be completed prior to June 1st, 1919.

[fol. 220] Article III. Specifications.—The specifications and drawings, if any, hereto annexed or herein referred to, are made a part of this contract with like effect as if herein set out in full. In the event of any conflict between the contract and the specifications or drawings the provisions of the contract shall govern.

From time to time, by written notice to the Contractor, the Contracting Officer may make changes in the specifications and drawings or supplemental or substituted specifications and drawings. If any such change increases the cost to the Contractor, a fair addition shall be made to its compensation; but if it reduces such cost a fair deduction shall be made therefrom, all as shall be determined by the Chief of Ordnance. No claim for additional compensation hereunder shall be allowed, nor shall the compensation be reduced, unless the change has been ordered in writing. For any delay in delivery attributable to such changes a corresponding extension of time shall be allowed the Contractor.

Article IV. Component parts to be furnished by United States.—The United States shall furnish without cost to the Contractor the materials and component parts listed on Schedule 2, in quantities determined by the Chief of Ordnance to be requisite for the performance of this contract. Should the Contractor be delayed in making deliveries of the articles by reason of delays in the furnishing of such materials or component parts by the United States, a corresponding extension of time shall be allowed the Contractor.

In addition to the raw materials and component parts listed on Schedule 2, the United States may from time to time, at its option, furnish to the Contractor other materials and component parts for use in the performance of this contract: Provided, however, That the Contractor has not previously and in good faith contracted for the purchase of such materials or component parts. Unless it is provided in writing that materials and component parts (other than those listed on Schedule 2) are furnished by the United States without charge, the United States shall be credited with the value thereof f. o. b. Contractor's plant, fixed at the estimated cost of such materials or component parts used in determining the contract price of the articles, the Contractor to pay demurrage, storage, cartage, and switching charges. Payments for the articles shall be reduced accordingly.

All materials and component parts furnished by the United States shall comply with specifications and shall remain the property of the United States. The Contractor shall account for all materials and component parts furnished by the United States, the cost of which has not been paid by or deducted from payments made to the Contractor, in finished product, scrap, unused material or otherwise and shall make such disposition thereof as may be ordered in writing by the Chief of Ordnance. Upon final delivery of the articles, and prior to final payment thereof, the Contractor shall deliver to the Chief of Ordnance a sworn statement, in form satisfactory to him, of the quantity of such unused material or component parts remaining in the Contractor's possession.

[fol. 221] Article V. Change in Amounts.—This contract may be considered as completed and so certified by the Chief of Ordnance upon delivery to and acceptance by the United States of the articles, plus or minus 5 per cent thereof. In the former case there shall be a proportionate increase and in the latter case a proportionate decrease in the total amount payable under this contract.

Article VI. Delivery.—The articles shall be suitably packed, boxed and marked by the Contractor, as directed from time to time by the Chief of Ordnance, and shall be delivered by the Contractor f. o. b. cars at the railroad station nearest to the place of manufacture, unless some

other place of delivery is herein specified. The Contractor shall, at the cost of the United States, ship the articles to any point in the United States designated by the Chief of Ordnance.

Article VII. Payment.—The United States shall pay to the Contractor the prices hereinbefore stated for all articles as and when delivered to and accepted by the United States. All payments shall be subject to correction for errors, if any.

Article VIII. Time.—Time is of the essence of this contract. The Contractor shall give the performance hereof preference and priority over any other work except work heretofore given preference or priority by the United States. It shall, from time to time, and whenever requested so to do, furnish the Contracting Officer reports on the progress of the work.

Article IX. Inspection—Rejection.—All materials and component parts unused or in process, the machinery, the equipment and the plant used in the performance of this contract, and the finished articles, shall at all times be subject to inspection by persons designated by the Chief of Ordnance, and the Contractor shall furnish reasonable facilities and assistance for all such inspection and for testing. Whatever of the materials or component parts not furnished by the United States, or of the articles, do not in all respects comply with the requirements of this contract, shall be rejected, and the decision of the Chief of Ordnance with respect thereto shall be final. The Chief of Ordnance may require the replacement of all rejected materials, component parts, and articles, and the United States may withhold from the payments to be made hereunder an amount sufficient to cover the cost thereof until such replacement. Upon notice from the Contractor that the articles, or any of them, are completed and ready for delivery final inspection shall be promptly made by the United States.

The process of manufacture shall be at all times subject to the inspection and supervision of the Chief of Ordnance.

Article X. Care of Property.—The Contractor shall use due and proper care to protect all property of the United

States in its possession. Such property shall be suitably marked for identification and shall be kept separate and apart from other property.

Article Xa. Upon presentation of the proper certificate of the inspecting and receiving officer of the United States payment under this contract will be made at the unit price herein set forth as each unit is delivered to and accepted by the United States.

All payments shall be subject to correction for errors.

[fol. 222] Article Xb. Costs under Article XIV shall be determined in accordance with the pamphlet entitled "'Definition of 'Cost' Pertaining to Contracts", issued by the Office of the Chief of Ordnance, War Department, dated June 27, 1917, made a part hereof by reference.

Article XI. Storage.—The Contractor shall provide at its plant storage capacity sufficient for the storage of sixty (60) days' deliveries of articles at the rate of deliveries herein specified. From time to time, and for so long as the Chief of Ordnance may require, the Contractor shall safely and adequately store to the extent of such storage capacity any accepted articles which the United States is not ready to have shipped; such storage to be at the risk of the United States but at the cost of the Contractor. By written notice the Chief of Ordnance at any time may require the Contractor promptly to furnish additional storage capacity sufficient to store not more than — days' additional deliveries at said rate. Thereafter from time to time and for so long as the Chief of Ordnance may require, the Contractor shall safely and adequately store any accepted articles to the extent of such additional storage capacity, but at the cost and risk of the United States. The additional storage capacity shall be furnished at the Contractor's plant, if practicable, and when that is not practicable, at a place adjacent to or near the plant. Subject to the approval of the Chief of Ordnance, such place shall be selected by and the arrangements made therefor by the Contractor. If a portion of the land and buildings then belonging to the Contractor be used for such additional storage, the United States will pay to the Contractor a reasonable rental therefor, to be agreed upon, or, in the absence of an agreement, to be fixed by the Chief of Ordnance.

The articles stored under the provisions of this article after final inspection and acceptance shall be paid for as though they had been delivered f. o. b. cars, but the Contractor shall thereafter, upon the request of the United States and at the expense of the United States, transport the articles stored to the nearest point of shipment by railroad, load the same on cars, and ship the same to such point of destination as the Chief of Ordnance may direct. The United States shall pay to the Contractor all expense incurred for transportation of the articles to storage and cost of unloading and reloading cars at place of storage.

Article XII. Excusable Delays.—The Contractor shall not be held responsible for delays in delivery determined by the Chief of Ordnance to be due to delay in inspection, delay in the giving of shipping instructions to the Contractor, explosions, fires, riots, labor strikes, acts of war, acts of God, or to any other causes beyond the control of the Contractor. The Contractor shall use its best efforts to remove such cause of delay as speedily as possible, and immediately upon the removal thereof shall proceed with the performance of this contract. The time for the making of deliveries shall be extended by the period of such delay, provided application therefor be made in writing within thirty (30) days after the removal of such cause for delay. Where, however, such delays have been substantial and not due to any act or omission of the United States the [fol. 223] Chief of Ordnance shall have the option either to cancel this contract or any of the deliveries that have been delayed upon the terms set forth in Article XIV hereof or to permit the Contractor to proceed with the performance of the contract.

Article XIII. Breach by Contractor.—If the Contractor shall abandon this contract or shall violate any material provision thereof, or shall fail at any time to prosecute with diligence the manufacture of the articles or the performance of this contract or if this contract shall be assigned, the Chief of Ordnance may, without prejudice to any other rights or remedies or to any claim which the United States may have, terminate this contract by written notice and complete the performance hereof or enter into agreements with other parties for the completion of the

performance hereof in whole or in part or purchase in the open market or otherwise any articles remaining undelivered hereunder; and the Contractor shall pay to the United States all loss and damage incurred as a result of such action.

Article XIV. Termination.—This contract being necessitated by a state of war now existing, it is desirable and expedient that provision be made for its cancellation upon fair and equitable terms in the event of the termination or limitation of the war, or if in anticipation thereof or because of changes in methods of warfare the Chief of Ordnance should be of the opinion that the completion of this contract has become unnecessary. It is therefore provided that at any time and from time to time, during the currency of this contract, the Chief of Ordnance may for any of the causes above stated notify the Contractor that any part or parts of the articles then remaining undelivered shall not be manufactured or delivered.

In the event of such complete or partial termination the United States shall inspect all completed articles then on hand and such as may be completed within thirty (30) days after such notice, and shall pay to the Contractor the price herein fixed for all articles accepted by and delivered to the United States. The United States shall also pay to the Contractor the cost of the materials and component parts purchased by the Contractor for the performance of this contract and then on hand in an amount not exceeding the requirements for the completion of this contract, provided they comply with the specifications, and also all costs shown by the Contractor to have been theretofore necessarily incurred in the performance of this contract and remaining unpaid; and the United States shall also protect the Contractor on all obligations incurred necessarily and solely for the performance of this contract of which the Contractor can not be otherwise relieved. To the above may be added such sums as the Chief of Ordnance may deem necessary to fairly and justly compensate the Contractor for work, labor and service rendered under this contract.

Title to all such materials and component parts paid for by the United States under this article shall, immediately upon such payment, vest in the United States.

[fol. 224] The United States may refuse to make any payment or to reimburse the Contractor for or on account of

material or component parts intended to form a part of the articles, whether unused or in the process of manufacture or manufactured, in respect of the delivery of which the Contractor shall be in arrears not due to causes beyond its control at the time of such termination.

Article XV. Precautionary Measures.—In addition to the ordinary precautions heretofore adopted by the Contractor for the guarding and protection of its plant and work, the Contractor shall provide such additional watchmen and devices for protection of its plants and property and the work in process for the United States against espionage, acts of war, and of enemy aliens as may be required by the Chief of Ordnance. The Contractor shall, when required, report to the Chief of Ordnance, the citizenship, country of birth, or alien status of any and all of its employees. When required by the Chief of Ordnance the Contractor shall refuse to employ, or if already employed, forthwith discharge from employment and exclude from its works any person or persons designated by the Chief of Ordnance for cause as undesirable for employment in a plant engaged on work for the United States. The United States shall pay to the Contractor as part of the cost of the articles any expense incurred by the Contractor which shall be determined by the Chief of Ordnance to be directly caused by the requirements of this article.

Article XVI. Exploitation Forbidden.—The Contractor agrees to refrain from exploiting by publicity or otherwise its products manufactured in pursuance of this contract, and of any and all contracts and orders heretofore or hereafter entered into or placed with the Contractor, and its products manufactured under any arrangements with the United States whatsoever, and the Contractor agrees to refrain from in any way publicly advertising the fact of the manufacture of said product, and to refrain from publishing or causing or allowing to be published any photographs, drawings, written or printed matter, or other data disclosing the articles, or parts of the same, or the process of manufacture, or the plans of the Government, or any information concerning the same or which shall result in such disclosure. The Contractor agrees to submit to the Chief of Ordnance all pictures or printed matter showing, describing, or in any way relating to the progress of the

work to be prosecuted under this contract and under any and all contracts and orders heretofore or hereafter entered into or placed with the Contractor, or under any arrangements with the United States whatsoever, which he may desire to publish, before publishing the same, and the Chief of Ordnance may prohibit such publication. The Contractor further agrees to refrain from giving any information whatsoever relative to any experiments that may be carried out by it at the instance of the United States.

Article XVII. Contract Not Assignable.—The contractor shall not assign, transfer, or otherwise dispose of this contract or any part thereof without the written consent of the Secretary of War, nor shall it assign any moneys due or to become due hereunder.

[fol. 225] Article XVIII. Subcontracts.—The Contractor shall insert in every contract hereafter made in relation to the performance of this contract, a provision that such contract may be assigned by the Contractor and that it relates to this contract. The Contractor shall, from time to time, upon request, exhibit to the Contracting Officer any and all contracts made in connection with the performance of this contract.

Article XIX. Waiver of Liens.—The Contractor hereby waives and releases all lien or right of lien now existing or that may hereafter arise for work or labor performed or materials furnished or for any other reason or cause under this contract, under any lien laws, State or Federal, upon any component parts, materials, supplies, and the like coming into its possession, which it is herein contemplated shall presently or ultimately become the property of the United States, and the Contractor agrees not to create or suffer to be created any mortgage, lien, pledge, attachment, or other encumbrance upon any such component parts, material, supplies, or other property in its possession intended to form a part of the articles to be delivered under this contract. In the event that such mortgage, pledge, lien, attachment or encumbrance is created, the Contractor agrees to pay and discharge, or if it disputes the validity of the claim out of which such encumbrance arises, immediately to bond same to the end that all property shall at all times be and remain free from all encumbrances.

Article XX. Disputes.—Except as herein otherwise specifically provided, any doubts or disputes which may arise under this contract or as to its performance or nonperformance shall be referred to the Chief of Ordnance for determination. If the Contractor shall feel aggrieved at his decision, it shall have the right of appeal to the Secretary of War, whose decision shall be final.

Article XXI. Patents.—The Contractor hereby covenants and agrees to hold and save the United States and all persons acting under them harmless from and against all and every demand or demands of any nature or kind for or on account of the adoption of any plan, model, design, or suggestion or for or on account of the use of any patented invention, article, or appliance that has been or may be adopted or used in or about the construction of said articles, or any part thereof, under this contract, and to protect and discharge the United States from all liability on account thereof, or on account of the use thereof, by proper releases from the patentees, and by bond if required, or otherwise, and to the satisfaction of the Chief of Ordnance.

Article XXII. Notice.—Any notice addressed to the Contractor at its principal office and either there delivered or deposited in a postpaid wrapper in any postoffice box regularly maintained by the United States, shall be deemed to have been served upon the Contractor. The address of the Contractor may be changed at any time by notice in writing to the Contracting Officer. Nothing herein contained shall preclude service of notices upon the Contractor (1) where it is a corporation by delivery thereof to any of its officers or directors in person; (2) where it is a firm by delivery thereof to one of the partners; (3) where it is an individual by delivery thereof to him in person.

[fol. 226] Article XXIII. Officials Not to Benefit.—No Member of or Delegate to Congress or Resident Commissioner is or shall be admitted to any share or part of this contract or to any benefit that may arise therefrom; but this article shall not apply to this contract so far as it may be within the operation or exception of section 116 of the act of Congress approved March 4, 1909 (35 Stats., 1109).

Article XXIV. Prison Labor.—No person or persons shall be employed in the performance of this contract who are undergoing sentences of imprisonment at hard labor which have been imposed by the courts of the several States, Territories, or municipalities having criminal jurisdiction.

In Witness Whereof, the parties hereto have caused this contract to be duly executed in triplicate by their respective officers, thereunto duly authorized, the day and year first above written.

Signatures: United States Cartridge Co., by C. E. Hoxie, Agt. (Seal.) United States of America, by R. P. Lamont, Lieut. Col., Ord. Dept., N. A.

Witnesses: Lena A. Monroe, T. C. Amos.

Schedule 1 Attached to and a Part of a Certain Contract Between the United States of America and United States Cartridge Company and Dated the 25th Day of July, 1918.

Each and every of the pamphlets, drawings, specifications, and other papers enumerated is made a part of the schedule and of the contract of which this schedule is a part.

Specifications: Ordnance Office Specifications Ga 145-0 last revised December 21, 1917.

Drawings: Ordnance Office Drawing 74-2-3 last revised September 19, 1917.

Schedule 2: None.

[fol. 227]

Ex. 6

Duplicate

(Form 2d Revised)

Supplemental Contract Between the United States of America and United States Cartridge Company, of Lowell, Massachusetts

War-Ord. P12289-3034A

[fol. 228]

Form 2d (Revised)

Partial-payment Supplemental Contract

This contract made this 8th day of April 1920, between the United States of America, by E. R. Lyman, Major,

Ordnance Department, United States Army, (hereinafter called "Contracting Officer") acting by direction of the Chief of Ordnance, United States Army, and under authority of the Secretary of War, party of the first part, and the United States Cartridge Company, a corporation organized and existing under and by virtue of the laws of the State of Massachusetts, and having an office at Lowell, Mass. (hereinafter called "Contractor") party of the second part,

Witnesseth, that

Whereas, the United States and the confractor heretofore, exeeuted a certain contract, War Ord. No. P12289-3034A, dated July 20, 1918, (herein called "original contract", which term also includes, wherever used herein, all agreements, if any, supplementary to said original contract except this agreement and any other supplemental agreements which may be dated subsequent to the date of this agreement); and

Whereas, the original contract has not been completely performed but in preparation for, and as a part of complete performance, the contractor has employed capital, performed services, expended money and incurred liabilities and obligations for which it has not been paid; and

Whereas, because of the suspension of hostilities it has become desirable and is to the best interests of the United States to reduce the amount of deliveries to be made under the original contract and to that end, on the ninth day of January, 1919, the contractor at the request of the United States has temporarily suspended (reduced) operations under the original contract, and it is now the purpose of the parties hereto to provide for complete termination of operations under the original contract (except such operations as may be necessary to complete delivery thereunder of a total, including all deliveries heretofore made, of One Million Nine Hundred Thirty One Thousand Three Hundred Thirty Two 49 Gr. Percussion Primers (1,931,332)

Now, therefore, the parties hereto agree as follows:

Article I. The existing rights and obligations of the parties hereto under the original contract shall remain in full force and effect except as herein expressly provided.

Article II. The total quantity of articles or work to be delivered or performed under the original contract and this

[fol. 229] supplemental agreement, including all deliveries heretofore made, shall be reduced to 1,931,332 49 Gr. Percussion Primers and inspection of the completed articles or work and acceptance thereof and payment therefor by the United States in accordance with the terms of the original contract shall continue until deliveries up to that amount have been completed, accepted and paid for.

Article III. The contractor agrees that, except as provided in Article II hereafter authorized in writing by the contracting officer, or other officer duly authorized by the Secretary of War, it will not perform any further work or services, or incur any further expenses or obligations in connection with the performance of the uncompleted portion of said original contract, and will use its best efforts in every proper way to reduce such liabilities or obligations as have already been incurred in connection with such performance, and the contractor hereby, and for all times, waives all claim to the prospective profits which it might have made from the performance of that portion of said original contract which under the terms of this supplemental agreement will not be performed.

Article IV. In consideration of the premises and the faithful performance by the contractor of the foregoing covenant, the United States agrees to reimburse and remunerate the contractor for such proportion of his expenditures, obligations and liabilities necessarily incurred, including work, labor and services necessarily rendered, in connection with the performance of the original contract as is properly and fairly apportionable to the uncompleted portion thereof, and for expenditures properly incurred and services properly rendered under this supplemental agreement, as follows:

Section A. For raw materials, direct and indirect, and component parts on hand, in an amount not exceeding the requirements for the completion of the contract: Cost plus inward handling charges plus such portion of overhead as is directly applicable, less such sums as may represent the fair agreed value of all or any portion thereof, if the title and possession of the same are retained by the contractor.

Section B. For articles in process, in an amount not exceeding the requirements for the completion of the con-

tract: Cost of raw material and labor plus such portion of overhead as is directly applicable, less such sums as may represent the fair agreed value of all or any portion thereof, if the title and possession of the same are retained by the contractor.

Section C. A fair and equitable remuneration (1) for expenses and services of the contractor in connection with the items included in Section A of this Article, but not to exceed interest at 6% per annum on the capital invested therein, or if the capital was borrowed interest at the rate [fol. 230] paid by the contractor; and (2) for expenses and services of the contractor in connection with the items included in Section B of this Article, but not to exceed 10% of the cost thereof.

Section D. Such amounts as are properly paid by the contractor in the adjustment and termination of unperformed subcontracts and unperformed commitments for supplies which were properly entered into or made in connection with the performance of said original contract.

Section E. Payrolls and expenses paid or incurred with the approval of the Contracting Officer, or properly paid or incurred without such approval for the custody and protection of property, since the date of suspension above recited and pending final settlement.

Section F. Where special facilities were properly provided in connection with the performance of the original contract, necessity of which was contemplated by the contractor and included in his estimate of cost at the time the original contract was made, such portion of the cost thereof as would reasonably have been recouped had the uncompleted portion of the original contract been performed. The amount so allowed shall not exceed a sum which shall be computed as follows: from the cost of such special facilities deduct their fair value at the date hereof, and state such portion of the remainder as is represented by the ratio of the uncompleted portion to the whole of the original contract.

Section G. Such additional sums, if any, as the Secretary of War may deem necessary fairly and justly to compen-

sate the contractor for expenditures, obligations and liabilities necessarily incurred, including work, labor and service necessarily rendered, under the original contract or in preparation for the performance thereof, or under this supplemental ageement.

Article V. Title to all property paid for by the United States under the original contract and under this supplemental agreement shall vest in the United States immediately upon payment therefor.

Article VI. The United States shall proceed with the contractor to determine and from time to time will pay to the contractor such other sum or sums as may be found justly due for any separable item or items included within Article IV hereof, provided, however, that in no event shall the aggregate payments made or to be made under this supplementary agreement and under the original contract exceed the amounts which would have been payable under the original contract if the same had been fully performed.

Article VII. When any sum is found to be justly due for such items or items the finding shall be evidenced by a cer-
[fol. 231] tificate of the contracting officer, or other officer duly authorized by the Secretary of War, which certificate shall state the amount to be paid as above provided and the item or items on account of which such payment is to be made, and if any property is to be transferred or delivered in connection with or as a considertion for such payment, said certificate shall list the property so to be transferred or delivered. The acceptance by the contractor of payment under any such certificate shall constitute a release of all the contractor's rights then existing or which may thereafter exist growing out of or relating to such item or items.

Article VIII. In the event of the transfer or delivery to the United States of any property, the contractor shall expressly warrant all such property as free and clear of all encumbrances either legal or equitable, and shall either deliver the same to the United States or if requested shall care for, mark for identification and arrange for storage of same in a manner which shall be mutually agreeable.

Article IX. This agreement shall not become a valid or binding obligation of either party hereto unless and until

the approval of the Boston Ordnance District Claims Board has been noted at the end of this instrument.

In witness whereof the parties hereto have executed and delivered this agreement in sextuplicate as of the date first hereinabove written.

Witnesses:

(Sgd.) Constance Waite, as to

United States of America, by (Sgd.) E. R. Lyman, Major, Ord. Dept., U. S. Army, Contracting Officer.

(Sgd.) P. F. Dinsmore, as to

United States Cartridge Company, (Sgd.) by W. R. B. Whittier, Treas., Contractor.

Approved.

Boston Ordnance District Claims Board, (Sgd.) by William A. Cook, Member.

Dated Boston, Mass., the 8th day of April, 1920.

[fol. 232] Boston District Claims Board

Contracting Officer's Certificate

I hereby certify that I have satisfied myself of the authority of the person signing the Contractor's name to this agreement to bind it in the matter, and I have waived the filing of evidence of such authority as permitted so to do by Army Regulations.

(Sngd.) E. R. Lyman, Major, Ord. Dept., U. S. Army, Contracting Officer.

[fol. 233] EXHIBIT 7

(Form 2d Revised)

Supplemental Contract Between the United States of America and United States Cartridge Company, of Lowell, Massachusetts

War Ord. GA-126

[fol. 234] Form 2d (Revised)

Partial-payment Supplemental Contract

This contract made this 27th day of March 1920, between the United States of America, by E. R. Lyman, Major, Ordnance Department, United States Army, (hereinafter called "Contracting Officer") acting by direction of the Chief of Ordnance, United States Army, and under authority of the Secretary of War, party of the first part, and the United States Cartridge Company, a corporation organized and existing under and by virtue of the laws of the State of Massachusetts, and having an office at Lowell, Mass., (hereinafter called "Contractor") party of the second part,

Witnesseth, that

Whereas, the United States and the contractor heretofore executed a certain contract, War Ord. No. GA-126 dated August 22, 1917 (herein called "original contract", which term also includes, wherever used herein, all agreements, if any, supplementary to said original contract except this agreement and any other supplemental agreements which may be dated subsequent to the date of this agreement); and

Whereas, the original contract has not been completely performed but in preparation for, and as a part of complete performance, the contractor has employed capital, performed services, expended money and incurred liabilities and obligations for which it has not been paid; and

Whereas, because of the suspension of hostilities it has become desirable and is to the best interests of the United States to reduce the amount of deliveries to be made under the original contract and to that end, on the ninth day of January, 1919, the contractor at the request of the United

States has temporarily suspended (reduced) operations under the original contract, and it is now the purpose of the parties hereto to provide for complete termination of operations under the original contract (except such operations as may be necessary to complete delivery thereunder of a total, including all deliveries heretofore made, of Four Million Five Hundred Ninety-four Thousand Seven Hundred Five, (4,594,705), 110 Gr. Primer Bodies.

Now, therefore, the parties hereto agree as follows:

Article I. The existing rights and obligations of the parties hereto under the original contract shall remain in full force and effect except as herein expressly provided.

[fol. 235] Article II. The total quantity of articles or work to be delivered or performed under the original contract and this supplemental agreement, including all deliveries heretofore made, shall be reduced to 4,594,705—110 Gr. Primer Bodies and inspection of the completed articles or work and acceptance thereof and payment therefor by the United States in accordance with the terms of the original contract shall continue until deliveries up to that amount have been completed, accepted and paid for.

Article III. The contractor agrees that, except as provided in Article II hereafter authorized in writing by the contracting officer, or other officer duly authorized by the Secretary of War, it will not perform any further work or services, or incur any further expenses or obligations in connection with the performance of the uncompleted portion of said original contract, and will use its best efforts in every proper way to reduce such liabilities or obligations as have already been incurred in connection with such performance, and the contractor hereby, and for all times, waives all claim to the prospective profits which it might have made from the performance of that portion of said original contract which under the terms of this supplemental agreement will not be performed.

Article IV. In consideration of the premises and the faithful performance by the contractor of the foregoing covenant, the United States agrees to reimburse and remunerate the contractor for such proportion of his expenditures, obligations and liabilities necessarily incurred, including work, labor and services necessarily rendered, in

connection with the performance of the original contract as is properly and fairly apportionable to the uncompleted portion thereof, and for expenditures properly incurred and services properly rendered under this supplemental agreement, as follows:

Section A. For raw materials, direct and indirect, and component parts on hand, in an amount not exceeding the requirements for the completion of the contract:—Cost plus inward handling charges plus such portion of overhead as is directly applicable, less such sums as may represent the fair agreed value of all or any portion thereof, if the title and possession of the same are retained by the contractor.

Section B. For articles in process, in an amount not exceeding the requirements for the completion of the contract:—Cost of raw material and labor plus such portion of overhead as is directly applicable, less such sums as may represent the fair agreed value of all or any portion thereof, if the title and possession of the same are retained by the contractor.

Section C. A fair and equitable remuneration (1) for expenses and services of the contractor in connection with the items included in Section A of this Article, but not to exceed interest at 6% per annum on the capital invested therein, or if the capital was borrowed interest at the rate paid by the contractor; and (2) for expenses and services of the contractor in connection with the items included in Section B of this Article, but not to exceed 10% of the cost thereof.

[fol. 236] Section D. Such amounts as are properly paid by the contractor in the adjustment and termination of unperformed subcontracts and unperformed commitments for supplies which were properly entered into or made in connection with the performance of said original contract.

Section E. Payrolls and expenses paid or incurred with the approval of the Contracting Officer, or properly paid or incurred without such approval for the custody and protection of property, since the date of suspension above recited and pending final settlement.

Section F. Where special facilities were properly provided in connection with the performance of the original

contract, necessity of which was contemplated by the contractor and included in his estimate of cost at the time the original contract was made, such portion of the cost thereof as would reasonably have been recouped had the uncompleted portion of the original contract been performed. The amount so allowed shall not exceed a sum which shall be computed as follows: from the cost of such special facilities deduct their fair value at the date hereof, and state such portion of the remainder as is represented by the ratio of the uncompleted portion to the whole of the original contract.

Section G. Such additional sums, if any, as the Secretary of War may deem necessary fairly and justly to compensate the contractor for expenditures, obligations and liabilities necessarily incurred, including work, labor and service necessarily rendered, under the original contract or in preparation for the performance thereof, or under this supplemental agreement.

Article V. Title to all property paid for by the United States under the original contract and under this supplemental agreement shall vest in the United States immediately upon payment therefor.

Article VI. The United States shall proceed with the contractor to determine and from time to time will pay to the contractor such other sum or sums as may be found justly due for any separable item or items included within Article IV hereof, provided, however, that in no event shall the aggregate payments made or to be made under this supplementary agreement and under the original contract exceed the amounts which would have been payable under the original contract if the same had been fully performed.

Article VII. When any sum is found to be justly due for such item or items the finding shall be evidenced by a certificate of the contracting officer, or other officer duly authorized by the Secretary of War, which certificate shall state the amount to be paid as above provided and the item or items on account of which such payment is to be made, and if any property is to be transferred or delivered in connection with or as a consideration for such payment, said certificate shall list the property so to be transferred

or delivered. The acceptance by the contractor of payment under any such certificate shall constitute a release of all the contractor's rights then existing or which may thereafter exist growing out of or relating to such item or items.

[fol. 237] Article VIII. In the event of the transfer or delivery to the United States of any property, the contractor shall expressly warrant all such property as free and clear of all encumbrances either legal or equitable, and shall either deliver the same to the United States or if requested shall care for, mark for identification and arrange for storage of same in a manner which shall be mutually agreeable.

Article IX. This agreement shall not become a valid or binding obligation of either party hereto unless and until the approval of the Boston Ordnance District Claims Board has been noted at the end of this instrument.

In witness whereof the parties hereto have executed and delivered this agreement in sextuplicate as of the date first hereinabove written.

Witnesses:

(Sgd.) Jno. M. Hayes, as to

United States of America, (Sgd.) by E. R. Lyman, Major, Ord. Dept., U. S. Army, Contracting Officer.

(Sgd.) P. F. Dinsmore, as to

United States Cartridge Company, (Sgd.) by W. R. B. Whittier, Treas., Contractor. (Seal.)

Approved.

Boston Ordnance District Claims Board, by (Sgd.) William A. Cook, Member.

Dated, Boston, Mass., the 27th day of March, 1920.

[fol. 238] Boston District Claims Board

Contracting Officer's Certificate

I hereby certify that I have satisfied myself of the authority of the person signing the Contractor's name to this agreement to bind it in the matter, and I have waived the filing of evidence of such authority as permitted so to do by Army Regulations.

(Sgd.) E. R. Lyman, Major, Ord. Dept., U. S. Army, Contracting Officer.

[fol. 239]

EXHIBIT 20

Analysis of Use of Buildings on Plaintiff's Leaseholds at Lowell and South Lowell, Massachusetts, as Shown by Schedules Filed by Plaintiff on November 15, 1922, with the Commissioner of Internal Revenue

Use of buildings	January 1919	January 1920	January 1921	January 1922	New layout Oct. 1922
Machine occupied space:					
Ammunition Manufacture (Total)	41,547	73,411	107,577	107,577	81,444
Lowell Buildings	20,114	51,978	70,101	70,101	68,985
South Lowell Buildings	12,459*	12,459*	12,459*	12,459*	12,459*
	8,974	8,974	25,017	25,017	
Radiator Manufacture, Lowell Buildings	3,168	10,515	14,155	13,555	16,249
Motor Manufacture, Lowell Buildings	.....	.....	.....	5,991	.....
Paper Box Manufacture, South Lowell Buildings	.....	.....	16,892**	16,892**	.....
Wasting, annealing, hardening, Lowell Buildings	.....	.....	.....	.....	2,892
Service Departments:					
Power and Heating (Total)	7,033	7,033	7,033	7,033	5,496
Lowell Buildings	4,613	4,613	4,613	4,613	3,076
South Lowell Buildings	2,420	2,420	2,420	2,420	2,420
Shops (Total)	19,293	22,266	23,089	23,089	7,295
Lowell Buildings	16,500	19,473	19,473	19,473	5,427
South Lowell Buildings	2,793	2,793	3,616	3,616	1,868

EXHIBIT 20—Continued

	January 1919	January 1920	January 1921	January 1922	New layout Oct. 1922
Shipping, receiving and active storage for Manufacturing (Total)	28,239	31,526	26,682	26,682	15,211
Lowell Buildings	10,323	13,610	13,610	13,610	14,947
South Lowell Buildings	17,916	17,916	13,072	13,072	264
Plant, Wagon sheds, Barn, garages (Total)	3,099	3,099	3,099	3,099	2,305
Lowell Buildings	1,595	1,595	1,595	1,595	1,595
South Lowell Buildings	1,504	1,504	1,504	1,504	710
Laboratories (exc. ballistic) (Total)	81	81	81	81	1,100
Lowell Buildings	.....	.....	.....	.....	1,100
South Lowell Buildings	81	81	81	81	.....
Lavatories, Lowell Buildings	500	500	500	500	500
Offices, Lowell Buildings	7,531	7,915	7,839	7,839	2,446
Uses extraneous to Manufacture:					
Dead storage (company) (Total)	32,500	39,796	30,871	30,871	47,344
Lowell Buildings	7,295	14,591	5,897	5,897	10,766
South Lowell Buildings	25,205	25,205	24,974	24,974	36,578
Restaurants (Total)	5,428	5,678	5,373	5,373	.....
Lowell Buildings	3,305	3,555	3,250	3,250	.....
South Lowell Buildings	2,123	2,123	2,123	2,123	.....
Commercial Garage, Lowell Buildings	22,960	22,960	22,960	22,960	22,960
Construction Department, Lowell Buildings	.....	.....	.....	.....	6,804

[fol. 240]

Government storage (Total)	78,472	30,273	.....	.....	.....
Lowell Buildings	62,572	14,373	.....	.....	.....
South Lowell Buildings	15,900	15,900	.....	.....	.....
Idle and vacant space (Total)	33,117	27,915	16,817	11,426	70,922
Lowell Buildings	19,444	14,242	15,927	10,536	22,173
South Lowell Buildings	13,673	13,673	890	890	48,749

*Ballistic Laboratory.
**Company summary omits 2,000 sq. ft.

Summary of Preceding Analysis

Total Machine Occupied Space	44,715	83,926	138,624	144,015	100,585
Lowell Buildings	23,282	62,493	84,256	89,647	88,126
South Lowell Buildings	21,433	21,433	54,368	54,368	12,459
Total Service Departments	65,776	72,420	68,323	68,323	34,353
Lowell Buildings	41,062	47,706	47,630	47,630	29,091
South Lowell Buildings	24,714	24,714	20,693	20,693	5,262
Total Manufacturing Space (Machine occupied and Service Depts.)	110,491	156,346	206,947	212,338	134,938
Lowell Buildings	64,344	110,199	131,886	137,277	117,217
South Lowell Buildings	46,147	46,147	75,061	75,061	17,721
Total Extraneous Company Use of Buildings	60,888	68,434	59,204	59,204	77,108
Lowell Buildings	33,560	41,106	32,107	32,107	40,530
South Lowell Buildings	27,328	27,328	27,097	27,097	36,578

EXHIBIT 20—Continued

	January 1919	January 1920	January 1921	January 1922	New Layout Oct. 1922
Total Company Use of Buildings	171,379	224,780	266,151	271,542	212,046
Lowell Buildings	97,904	151,305	163,993	169,384	157,747
South Lowell Buildings	73,475	73,475	102,158	102,158	54,299
Government Storage (Total)	78,472	30,273			
Lowell Buildings	62,572	14,373	.....	.....	.....
South Lowell Buildings	15,900	15,900	.....	.....	.....
Total Use of Buildings	249,851	255,053	266,151	271,542	212,046
Lowell Buildings	160,476	165,678	163,993	169,384	157,747
South Lowell Buildings	89,375	89,375	102,158	102,158	54,299
Idle and Vacant Space (Total)	33,117	27,915	16,817	11,426	70,922
Lowell Buildings	19,444	14,242	15,927	10,536	22,173
South Lowell Buildings	13,673	13,673	890	890	48,749
Total Available Space	282,968	282,968	282,968	282,968	282,968
Lowell Buildings	179,920	179,920	179,920	179,920	179,920
South Lowell Buildings	103,048	103,048	103,048	103,049	103,048

[fol. 241]

EXHIBIT 21

Analysis of Use of Plaintiff's Leasehold and Annual Rental Buildings at Lowell and South Lowell, Massachusetts, as Shown by Schedules Filed by Plaintiff on November 15, 1922, with the Commissioner of Internal Revenue

Use of buildings	January 1919	January 1920	January 1921	January 1922	New layout Oct. 1922
Ammunition Manufacture (Total)	88,290	95,688	132,929	132,929	101,292
New Lowell Buildings	20,114	51,978	70,101	70,101	68,985
Rented Lowell Buildings	46,743	22,277	25,352	25,352	19,848
South Lowell Buildings	12,459*	12,459*	12,459*	12,459*	12,459*
	8,974	8,974	25,017	25,017	.....
Radiator Manufacture (Total)	3,168	16,665	20,305	19,705	16,249
New Lowell Buildings	3,168	10,515	14,155	13,555	16,249
Rented Lowell Buildings	.....	6,150	6,150	6,150	.....
Motor Manufacture (Total)	.....	5,209	21,670	5,991	3,523
New Lowell Buildings	.....	.....	.....	5,991	.....
Rented Lowell Buildings	.....	5,209	21,670	.....	3,528
Paper Box Manufacture, South Lowell Buildings	.....	.....	16,892**	16,892**	.....
Safety Razor Manufacture, Rented Lowell Buildings	.....	3,075	3,075	3,075	1,000
Wasting, Annealing, Hardening, New Lowell Buildings	.....	.....	.....	.....	2,892
Total Machine Occupied Space	91,458	120,637	194,871	178,592	124,961
New Lowell Buildings	23,282	62,493	84,256	89,647	83,126
Rented Lowell Buildings	46,743	36,711	36,247	34,577	24,376
South Lowell Buildings	21,433	21,433	54,368	54,368	12,459

EXHIBIT 21—Continued

	January 1919	January 1920	January 1921	January 1922	New Layout Oct. 1922
Power & Heating (Total)	11,499	10,974	11,499	10,974	5,496
New Lowell Buildings	4,613	4,613	4,613	4,613	3,076
Rented Lowell Buildings	4,466	3,941	4,466	3,941	.....
South Lowell Buildings	2,420	2,420	2,420	2,420	2,420
Shops (Total)	27,088	33,835	35,408	33,024	13,164
New Lowell Buildings	16,500	19,473	19,473	19,473	5,427
Rented Lowell Buildings	7,795	11,569	12,319	9,935	5,869
South Lowell Buildings	2,793	2,793	3,616	3,616	1,868
Shipping, Receiving and Active Storage for Manufacturing	37,370	48,550	55,648	50,148	48,932
New Lowell Buildings	10,323	13,610	13,610	13,610	14,947
Rented Lowell Buildings	9,131	17,024	28,966	23,466***	33,721***
South Lowell Buildings	17,916	17,916	13,072	13,072	284
Inspection and Salvage, Rented Lowell Buildings	.....	.....	991	.....	1,410
Plant, Wagon Sheds, Barn, Garages	5,455	5,455	5,455	5,455	4,131
New Lowell Buildings	1,595	1,595	1,595	1,595	1,595
Rented Lowell Buildings	2,356	2,356	2,356	2,356	1,826
South Lowell Buildings	1,504	1,504	1,504	1,504	710
Laboratories (exc. ballistic)	81	81	81	81	1,100
New Lowell Buildings	.....	.....	.....	.....	1,100
South Lowell Buildings	81	81	81	81	.....

[fol. 242]

Lavatories					
New Lowell Buildings	500	500	500	500	500
Offices (Total)	9,818	10,202	10,126	10,126	5,620
New Lowell Buildings	7,531	7,915	7,839	7,839	2,446
Rented Lowell Buildings	2,287	2,287	2,287	2,287	3,174
Total Service Depts	91,811	109,597	119,708	110,308	80,353
New Lowell Buildings	41,062	47,706	47,630	47,630	29,091
Rented Lowell Buildings	26,035	37,177	51,385	41,985	46,000
South Lowell Buildings	24,714	24,714	20,693	20,693	5,262
Total Manufacturing Space, Including Service Departments.					
New Lowell Buildings	64,344	110,199	131,886	137,277	117,217
Rented Lowell Buildings	72,778	73,888	107,632	76,562	70,376
South Lowell Buildings	46,147	46,147	75,061	75,061	17,721
Total	183,269	230,234	314,579	288,900	205,314
Uses Extraneous to Manufacture.					
Dead Storage (Company)	50,580	65,167	51,132	36,121	57,836
New Lowell Buildings	7,295	14,591	5,897	5,897	10,766
Rented Lowell Buildings	18,080	25,371	20,261	5,260	10,492
South Lowell Buildings	25,205	25,205	24,974	24,974	36,578
Restaurants	5,428	5,678	5,373	5,373	.....
New Lowell Buildings	3,305	3,555	3,250	3,250	.....
South Lowell Buildings	2,123	2,123	2,123	2,123	.....

EXHIBIT 21—Continued

	January 1919	January 1920	January 1921	January 1922	New Layout Oct. 1922
Commercial Garage					
New Lowell Buildings	22,960	22,960	22,960	22,960	22,960
Construction Department					
New Lowell Buildings	.....	.....	.....	.....	6,804
Total Extraneous Company Uses	78,968	93,805	79,465	64,454	87,600
New Lowell Buildings	33,560	41,106	32,107	32,107	40,530
Rented Lowell Buildings	18,080	25,371	20,261	5,250	10,492
South Lowell Buildings	27,328	27,328	27,097	27,097	36,578
Total Company Use of Buildings	262,237	324,039	394,044	353,354	292,914
New Lowell Buildings	97,904	151,505	163,993	169,384	157,747
Rented Lowell Buildings	90,858	99,259	127,893	81,812	80,868
South Lowell Buildings	73,475	73,475	102,158	102,158	54,299
Government Storage	112,537	36,781(a)	.....	.....	.....
New Lowell Buildings	62,572	14,373	.....	.....	.....
Rented Lowell Buildings	34,065	6,508	.....	.....	.....
South Lowell Buildings	15,900	18,900	.....	.....	.....
Total Use of Buildings	374,774	360,820	394,044	353,354	292,914
New Lowell Buildings	160,476	165,678	163,993	169,384	157,747
Rented Lowell Buildings	124,923	105,767	127,893	81,812	80,868
South Lowell Buildings	89,375	89,373	102,158	102,158	54,299

Idle and Vacant Space	44,573	58,527	25,303	29,024	89,464
New Lowell Buildings	19,444	14,242	15,927	10,536	22,173
Rented Lowell Buildings	11,456	30,612	8,486	17,598	18,542
South Lowell Buildings	13,673	13,673	890	890	48,749
Total Available Space	419,347	419,347	419,347	382,378	382,378
New Lowell Buildings	179,920	179,920	179,920	179,920	179,920
****Rented Lowell Buildings	136,379	136,379	136,379	99,410	99,410
South Lowell Buildings	103,048	103,048	103,048	103,048	103,048

* Ballistic Laboratory.
** Company summary omits 2,000 sq. ft..
(a) Government storage 23,067 sq. ft. to December 1920.
*** Includes additional rented building in 1922 of 1500 square feet.
**** Above analysis does not account for 2955 square feet of annual rental buildings at Lowell, Mass.

[fol. 243]

EXHIBIT 22

Plaintiff's Leasehold Buildings at Lowell, Mass.

Schedule Showing Type of Construction of Buildings, Floor Area of Each Building, and Total Square Feet of Idle or Vacant Space in Each Building by Years. Description of Buildings (From Ford, Bacon & Davis' appraisal of Dec. 2, 1920)

	Building number	Total square feet of floor area	*Total square feet of idle or vacant space by years. January 1, 1919	January 1, 1920	January 1, 1921	January 1, 1922	New layout Oct. 1922
Frame Construction:							
One story	3-C	1,360	.....	.....	.....	.....	.....
One story	5	1,133	1,133	1,133	1,133	1,133	1,133
Two story	6	825	.....	.....	.....	.....	.....
Two story	7	996	.....	.....	.....	.....	.....
One story	8	2,387	.....	.....	.....	.....	.....
One story	9	156	.....	.....	.....	.....	.....
One story	10	942	.....	.....	.....	.....	.....
One story	11	344	.....	.....	.....	.....	.....
One story	12	653	.....	.....	.....	.....	.....
One story	15	982	.....	.....	.....	.....	.....
Two story	16-B	1,982	.....	.....	.....	.....	1,982
One story	20-D	1,389	.....	.....	.....	.....	1,389
Total frame construction		13,149	.....	.....	.....	.....	
Brick Construction:							
3 story brick, mill type	1-A	25,655	.....	.....	5,000	5,000	.....
One story—lavatory	1-B	336	.....	.....	.....	.....	.....
One story—lavatory	1-D	164	.....	.....	.....	.....	.....
Four story	1-E	24,264	2,973	.....	.....	.....	.....
One story	1-G	3,579	3,579	3,579	1,079	1,079	.....
One story	1-H	650	650	650	650	650	.....
One story	1-I	540	540	540	.....	.....	540

Three story, mill type	2	50,990	3,136	907	.....	.....	.....
Two story, mill type	3-A	2,464	.....	.....	632	1,232	.....
Two story, mill type	3-B	2,980	.....	.....	.....	.....	.....
One story	4'	1,442	1,442	1,442	1,442	1,442	1,442
Four story	20-A	23,970	5,991	5,991	5,991	.....	11,986
One story	20-C	2,164	.....	.....	.....	.....	2,164
One story	19-A	1,042	.....	.....	.....	.....	1,042
One story	19-D	495	.....	.....	.....	.....	495
Total brick construction		140,735	.....	.....	.....	.....	.....
Concrete:							
Coal bunker	17	3,076	.....	.....	.....	.....	.....
Two story garage	21	22,960	.....	.....	.....	.....	.....
Total concrete construction		26,036	.....	.....	.....	.....	.....
Total area of new construction at Lowell		179,920	.....	.....	.....	.....	.....
Total square feet of vacant and idle space			19,444	14,242	15,927	10,536	22,173

*Taken from schedules submitted by plaintiff to the Commissioner of Internal Revenue on November 15, 1922.

[fol. 244]

EXHIBIT 23

Plaintiff's Leasehold Buildings at South Lowell, Mass.

Schedule Showing Type of Construction of Buildings, Floor Area of Each Building, and Total Square Feet of Idle or Vacant Space in Each Building by Years

Description of buildings (from Ford, Bacon & Davis' appraisal of Dec. 2, 1920)	Building number	Total square feet of floor area	*Total square feet of idle or vacant space in buildings by years. January 1, 1919	January 1, 1920	January 1, 1921	January 1, 1922	New Layout Oct. 1922
Frame Construction:							
Commercial loading building	S-1A	4,235	.....	.....	.....	.....	4,235
" " "	S-1B	5,579	.....	.....	.....	.....	5,579
Restaurant	S-4	2,123	.....	.....	.....	.....	2,123
Part 1 story and part 2 story	S-6	12,459	.....	.....	.....	.....	.....
Storage building	S-7	1,144	.....	.....	.....	.....	.....
Gate house, one story	S-8	1,144	.....	.....	.....	.....	.....
One story	S-9	2,420	.....	.....	.....	.....	794
One story	S-10	2,881	.....	.....	.....	.....	2,881
One story	S-11	2,981	.....	.....	.....	.....	1,113
One story	S-12	360	.....	.....	.....	.....	.....
One story	S-13	264	.....	.....	.....	.....	.....
One story	S-14	665	665	665	665	665	665
Two story	S-15	225	225	225	225	225	225
One story	S-16	714	.....	.....	.....	.....	.....
One story	S-18	854	.....	.....	.....	.....	854
One story	S-19	600	.....	.....	.....	.....	600
One story	S-20	176	.....	.....	.....	.....	176
One story	7	81	.....	.....	.....	.....	81
Total frame construction		38,905	.....	.....	.....	.....	.....

Brick Construction:							
Soldering building, one story	S-2	12,783	12,783	12,783	.....	.....	12,783
Inspection " " "	S-3	34,720	.....	.....	.....	.....	.....
Military loading, one story	S-5	16,640	.....	.....	.....	.....	16,640
Total brick construction		64,143	.....	.....	.....	.....	.....
Total area of new construction at South Lowell		103,048	.....	.....	.....	.....	.....
Total square feet of idle or vacant space			13,673	13,673	890	890	48,749

*Taken from schedules submitted by plaintiff to the Commissioner of Internal Revenue on November 15, 1922.

[fol. 245]

EXHIBIT 24

Plaintiff's Buildings on Annual Rental Basis at Lowell, Mass.

Schedule Showing Type of Construction of Buildings, Floor Area of Each Building, and Total Square Feet of Idle or Vacant Space in Each Building by Years

Description of buildings (from plaintiff's exhibit #24)	Building number	Total square feet of floor area	*Total square feet of idle or vacant space in each building by years January 1, 1919	January 1, 1920	January 1, 1921	January 1, 1922	New Layout Oct. 1922
Frame construction:							
3 story and basement	1-B	24,600	221	.....	.....	6,150	.....
3 story and basement	1-C	16,731	2,226	.....	.....	5,728	.....
1 story	12	530	.....	.....	.....	.....	.....
2 story	13	1,826	.....	.....	.....	.....	.....
2 story and basement	16-A	5,962	3,862	3,862	3,862	3,862	1,762
2 story	18	4,315	1,435	1,435	1,435	Rental terminated in last ¼ 1921	
Not indicated	20-E	255	.....	.....	.....	.....	255
1 story	22-C	2,303	.....	2,303	.....	Rental terminated in last ¼ 1921	
2 story	22-G	914	.....	457	.....	" " " " " "	
2 story	23-A	3,753	.....	.....	.....	" " " " " "	
1 story	23-B	1,296	.....	.....	.....	" " " " " "	
Total frame construction		62,485	.....	.....	.....	.....	.....
Brick construction:							
4 story and basement	1-D	18,707	3,712	1,858	.....	1,858	.....
1 story	14	190	.....	.....	.....	.....	.....
1 story	19-BCDE	3,941	.....	.....	.....	.....	3,941
4 story	20-B	25,168	.....	.....	.....	.....	12,584
2 story	22-F	1,981	.....	990	990	Rental terminated in last ¼ 1921	
2 story	22-D	2,674	.....	2,674	.....	" " " " " "	
1 story	22-E	525	.....	525	.....	" " " " " "	
Total brick construction		53,186	.....	.....	.....	.....	.....

Stone and concrete construction:											
2 story	22-A	14,309	.....	14,309	.....	"	"	"	"	"	"
2 story	22-B	6,399	.....	2,199	2,199	"	"	"	"	"	"
Total stone and concrete construction		20,708	.....	.....	.....	.....		.....			
Total area of buildings on annual rental basis to January 1, 1922		136,379	.....	.....	.....	.....		.....			
Additional building rented in 1922 for storage purposes	24	1,500	.....	.....	.....	.....		.....			
Total area of buildings on annual rental basis		137,879	.....	.....	.....	.....		.....			
Total square feet of idle or vacant space			11,456	30,612	8,486	17,598		18,542			

Note: The above analysis does not account for 2955 square feet of rental space occupied by plaintiff.

[fol. 246] V. JUDGMENT OF THE COURT—April 6, 1931

At a Court of Claims held in the City of Washington on the 6th day of April, A. D., 1931, judgment was ordered to be entered as follows:

Upon the special findings of fact, which are made a part of the judgment herein, the court decides, as a conclusion of law, that the plaintiff is entitled to recover under the Italian contract, and judgment will be awarded for the amount to which it is entitled when a stipulation of the parties has been filed showing the amount due in accordance with the opinion. As to the other items of the claim, the petition is dismissed.

April 6, 1931 Entry of Judgment suspended.

By the Court

VI. ORDER ENTERING AMOUNT OF JUDGMENT FOR THE PLAINTIFF—Filed June 10, 1931

Order

This case comes before the court on a stipulation filed by the parties; and it appearing that on April 6, 1931, the [fol. 247] court filed special findings of fact and an opinion in which it was held that the plaintiff was entitled to recover under its Italian contract, but suspending the entry of judgment until the filing of a stipulation showing the amount due in accord with the court's decision; and it further appearing that on May 13, 1931, such stipulation was filed showing the amount so due plaintiff under said Italian contract to be $160,978.83, now therefore, it is ordered this 10th day of June, 1931, that judgment be and the same is entered in favor of the plaintiff in said sum of one hundred sixty thousand, nine hundred seventy-eight dollars and eighty-three cents ($160,978.83), with interest thereon at the rate of six per cent per annum from March 31, 1926, to such date as the Commissioner of Internal Revenue may determine under the provisions of subsection (b), section 177, of the Judicial Code, being a part of the revenue act of 1928.

By the Court.

F. W. B., Ch. J.

[fol. 248] Clerk's certificate to foregoing transcript omitted in printing.

[fol. 249] IN SUPREME COURT OF THE UNITED STATES

STIPULATION AS TO SUPPLEMENTAL CONTRACT RELATING TO CONTRACT No. P 12621-3124-A—Filed Sept. 3, 1931

It is hereby stipulated that the supplemental contract relating to Contract No. P 12621-3124 A, referred to in the Special Finding of the Court of Claims, numbered 31, was not introduced in evidence; but that it was similar in form to the other supplemental contracts referred to in said finding, which were a part of the record in said case.

Harry LeBaron Sampson, Counsel for Petitioner.
T. D. Thacher, Solicitor General. C. B. R.

[fol. 250] [File endorsement omitted.]

[fol. 251] IN SUPREME COURT OF THE UNITED STATES

STIPULATION RE OMISSION OF CERTAIN EXHIBITS—Filed Sept. 3, 1931

It is hereby stipulated that the exhibits contained in pages 108 to 161, inclusive, of the certified transcript of the record of said case in the Court of Claims, (being Items 3 to 7, inclusive, and 10 and 11 in the list of exhibits contained in said transcript) are not material to the issues raised by the petition for certiorari filed in said case and that the same may be omitted in printing the record.

Harry LeBaron Sampson, Counsel for Petitioner.
T. D. Thacher, Solicitor General. C. B. R.

[fol. 252] [File endorsement omitted.]

SUPREME COURT OF THE UNITED STATES

ORDER ALLOWING CERTIORARI—Filed November 23, 1931

The petition herein for a writ of certiorari to the Court of Claims is granted. And it is further ordered that the duly certified copy of the transcript of the proceedings below which accompanied the petition shall be treated as though filed in response to such writ.

FILE COPY

OCT 7

CHARLES ELMORE

Supreme Court of the United States.

OCTOBER TERM, 1931.

No. 348

UNITED STATES CARTRIDGE COMPANY Petitioner,

v.

THE UNITED STATES.

BRIEF IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI.

HARRY LEBARON SAMPSON,
Counsel for Petitioner
Boston, Massachusetts.

INDEX.

	PAGE
I. Opinion of the Court Below	1
II. Jurisdiction of this Court	1
III. Statement of the Case	2
IV. Specification of Errors	4
V. Argument	5
A. Certiorari should be granted to review the decision with respect to the deduction for cost of buildings	5
(1) The decision of the Court of Claims is inconsistent with the case of *Burnet* v. *Niagara Falls Brewing Co.*, 282 U. S. 648, which is an authority in favor of the deduction claimed	8
(2) The fact that the petitioner's buildings became obsolete for the purpose for which they were built within a single tax year is not a bar to the deduction claimed	11
(3) The allowances made by the Commissioner of Internal Revenue in the years 1919–1924 on account of the cost of the buildings are not a bar to relief	11
B. Certiorari should be granted to correct the decision of the Court below with respect to the valuation of inventories under the contracts with the United States which were suspended.	12
(1) On December 31, 1918, this inventory did not include anything which was to be used to make such completed articles as were called for by the contracts	13
(2) On December 31, 1918, the petitioner had no contracts with the United States by which the United States agreed to accept these inventories and to pay for them at cost.	13

PAGE

(3) On December 31, 1918, it was wholly uncertain whether the petitioner would reach any settlements of its contracts and whether, if it did, the settlements would involve the taking over of the inventories and payment for them at cost. 15

(4) Up to the time of the partial settlements made in 1920 the petitioner had no agreement that its inventories would be taken over and paid for at cost, and up to the time of the final settlements made in 1921–1922, the amount which the petitioner was to be paid was unliquidated. 17

(5) Under the circumstances which have been stated the inventories should have been valued at their market value on December 31, 1918, ($231,615.43) and not at the amount ($732,088.62) which was realized for them in later years through the settlement agreements. 17

(a) The income which Congress intended to tax by the Revenue Act of 1918 was income which was so realized as to be available to the taxpayer according to ordinary business usage and the petitioner's inventories were so available only at their market value. 18

(b) The system of taxation contained in the Revenue Act of 1918 is based on an annual accounting period; and the petitioner's inventories should therefore be taken at their value at the end of 1918. 18

(c) The decision of the Court of Claims is inconsistent with good accounting practice, which is recognized by the Revenue Act of 1918 and by the regulations as a standard. 20

(d) The decision of the Court of Claims is contrary to the particular provisions of the regulations which relate specifically to the valuation of inventories and to the proceeds of the settlement of claims on Government contracts. 22

PAGE

(e) The argument that valuing the inventories at market permits the petitioner to take a loss before it is sustained is not valid. 26

C. The statutes and regulations should be liberally construed in favor of the taxpayer. 27

D. The questions involved are of general importance. 27

VI. Conclusion. 28

CASES CITED.

PAGE

Burnet *v.* Niagara Falls Brewing Co., 282 U. S. 648 . . 8, 27

Burnet *v.* Sanford & Brooks Co., 282 U. S. 359 . . . . 19, 26

Campbell *v.* Galeno Chemical Co., 281 U. S. 599 . . . 10

College Point Boat Corporation *v.* United States, 267 U. S. 12 . . . . . 14, 15, 17

Dorris Motor Car Co. *v.* United States, 60 C. Cls. 68 . 17

Duffy *v.* Central R. R. Co. of New Jersey, 268 U. S. 55 9

Guerini Stone Co. *v.* Carlin Construction Co., 248 U. S. 334 16

International Ry. Co. *v.* Davidson, 257 U. S. 506 . . . 10

Lucas *v.* American Code Co. Inc., 280 U. S. 445 . . . 20

Lucas *v.* Kansas City Structural Steel Co., 281 U. S. 264 19

Marigold Garden Co., 6 B.T.A. 368 10

McCabe Lathe & Machinery Co., 9 B.T.A. 1137 . . . 10

Niagara Falls Brewing Co., 13 B.T.A. 1040 10

Power *v.* United States, 18 C. Cls. 263 16

Producers Fuel Company, 1 B.T.A. 202 19

Savage Arms Corporation *v.* United States, 57 C. Cls. 71. 17

PAGE

Star Brewing Co., 7 B.T.A. 377 10
Tennessee Fibre Co., 15 B.T.A. 133 10
United States *v.* Behan, 110 U. S. 338 16
United States *v.* George, 228 U. S. 14 10
United States *v.* United States Fidelity & Guaranty Co., 236 U. S. 512 16
Yough Brewing Co., 4 B.T.A. 612 10

STATUTES AND REGULATIONS CITED.

PAGE

Judicial Code:
Sec. 240 as amended by Act of February 13, 1925 (43 Stat. 936) 1

Revenue Act of 1918 (40 Stat. 1057):
Sec. 203 . . . . . 12, 20
Sec. 234 (a) 5

Regulations 45:
Arts. 22–24 . . . . . 13, 21
Art. 109 9
Art. 143 6
Arts. 161–162 6
Arts. 1582–1584 . . . . . 13, 22

Regulations 65:
Art. 50 . . . . . 13, 24, 26
Arts. 1612–1614 . . . . . 13, 22

Supreme Court of the United States.

OCTOBER TERM, 1931.

UNITED STATES CARTRIDGE COMPANY, PETITIONER.
v.
THE UNITED STATES.
No. 348.

BRIEF IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI.

I.

The Opinion of the Court Below.

The opinion in the Court of Claims is reported in 48 F. (2d) 983. It is printed at pp. 88–110 of the record in this case.

II.

Jurisdiction of this Court.

The jurisdiction of this Court is based on the Judicial Code, section 240, as amended by Act of February 13, 1925 (43 Stat. 936). The material portion of this section is as follows:

> "(b) In any case in the Court of Claims, including those begun under section 180 of the Judicial Code, it shall be competent for the Supreme Court, upon the petition of either party, whether Government or claimant, to require, by certiorari, that the cause, including the findings of fact and the judgment or decree, but omitting the evidence, be certified to it for review and determination with the same power and authority, and with like effect, as if the cause had been brought there by appeal."

The petition in the Court of Claims was brought to recover an alleged overpayment of taxes for 1918 amounting to $843,589.12, with interest. The petitioner alleged that the Commissioner of Internal Revenue had made three errors in computing the petitioner's income for 1918, namely, (1) an error in valuing a certain inventory called the Maxim or Italian contract inventory, (2) an error in refusing to allow a deduction of a portion of the cost of certain buildings and (3) an error in valuing certain inventories relating to contracts with the United States. There was, however, but one cause of action and the errors claimed affected merely the amount of the judgment to be entered, if any. The Court made special findings of fact and on those findings ruled in the petitioner's favor with respect to the first of the alleged errors and in favor of the United States with respect to the other two. Final judgment for the petitioner was entered in the Court of Claims on June 10, 1931, for $160,978.83 with interest (R. 200). The amount of this judgment corrected the first alleged error but not the second or the third. The petition for a writ of certiorari was filed on September 3, 1931.

III.

Statement of the Case.

A concise statement of the case has been made in the petition for certiorari under the heading, "Statement of Matters involved" (R. 1–10). In the interest of brevity the facts there stated are not repeated in this brief.

The following additional facts relate to the amounts of the taxes (excluding interest) and of the petitioner's income. All the taxes assessed have been paid (Special Findings 3–6, R. 59–60).

Total taxes assessed by Commissioner (Finding 4, R. 59) . . .	$1,152,123.53
Reduction by Court of Claims account Maxim (Italian) inventory question (R. 200)	160,978.83

Net tax according to decision of Court of Claims		$991,144.70
Net income as determined by Commissioner (Finding 4, R. 59)	$1,792,432.58	
Reduction in income account overvaluation Italian inventory ($274,659.78–79,297.11 — Finding 20, R. 66)	195,362.67	
Net income according to decision of Court of Claims	1,597,069.91	
Amounts involved in pending petition for certiorari:		
Deduction for cost of buildings (Finding 49, R. 79–80) $327,937.35		
U. S. inventory question ($732,088.62–231,615.43 Finding 41, R. 76) 500,473.19		
Total deductions claimed . . .	828,410.54	
Net income, after deducting items in dispute		768,659.37
Amount by which tax according to decision of Court of Claims exceeds entire net income as claimed by petitioner		222,485.33
Excess profits tax credit (Finding 4, R. 59) . . .		$369,464.68
War profits tax credit (Finding 4, R. 59)		461,080.84

Taxes on all income in excess of the war profits credit ($461,080.84) amount to 80% of such income for the war profits taxes and excess profits taxes, plus 12% of the remaining 20% of such income (or 2.4%) for income taxes, or a total of 82.4% of such income (Revenue Act of 1918, secs. 301(a), 230(a), 236).

It follows that the amounts of taxes involved in the pending questions are:

Cost of buildings deduction (82.4% of $327,937.35)	$270,220.38
U. S. inventory question (82.4% of $500,473.19)	412,389.91

IV.

Specification of Errors.

The petitioner contends that the Court below erred in the following respects:

1. The Court below erred in not allowing the petitioner a deduction of $327,937.35 from its gross income for 1918 on account of the cost of buildings erected by the petitioner on leased land, in addition to the deduction of $86,484.54 which was allowed by the Commissioner of Internal Revenue.

2. The Court below erred in denying to the petitioner a deduction from its gross income for the year 1918 on account of the cost of buildings erected by it on leased land in addition to the deduction of $86,484.54 allowed by the Commissioner of Internal Revenue.

3. The Court below erred in failing to rule that in determining the petitioner's income for the year 1918, the inventories of the petitioner on hand at the end of that year, which the petitioner had acquired for use under its contracts with the United States which had been suspended, should be valued at their market value on December 31, 1918.

The foregoing are the fundamental errors claimed by the petitioner which are intended to include the following subsidiary errors which are assigned:

4. The Court below was in error in holding and ruling that the use which was made by the petitioner of its buildings after 1918 was a bar to a deduction for obsolescence in addition to the deduction of $86,484.54 allowed by the Commissioner of Internal Revenue.

5. The Court below was in error in holding and ruling that under the terms of the cancellation clauses in the petitioner's contracts with the United States, the petitioner became entitled during the year 1918 to be paid for its inventories at cost.

6. The Court below was in error in holding and ruling that the inventories of the petitioner intended for use under its contracts with the United States should be valued as of the end of the year 1918 according to the amounts received for them in settlements made in later years.

7. The Court below was in error in holding and ruling that the decision of the Board of Tax Appeals in *Producers Fuel Co.*, 1 B. T. A. 202 was applicable to the case at bar.

V.

Argument.

This brief is directed to the question whether the writ of certiorari should be granted. Accordingly it will deal only with the main points involved. A summary of the argument is contained in the subject index at the beginning of this brief. Every effort has been made to condense the argument, although each of the two important questions involved requires separate treatment.

A. Certiorari should be granted to review the decision with respect to the deduction for cost of buildings.

The statute involved is section 234(a) of the Revenue Act of 1918 the material portion of which reads as follows:

> "Sec. 234 (a) That in computing the net income of a corporation subject to the tax imposed by section 230 there shall be allowed as deductions . . .
>
> (4) Losses sustained during the taxable year and not compensated for by insurance or otherwise; . . .
>
> (7) A reasonable allowance for the exhaustion, wear and tear of property used in the trade or business, including a reasonable allowance for obsolescence;"

The principal regulations referred to by the parties are quoted in the opinion of the Court of Claims at pages 103–105 of the record. They include Regulations 45, arts. 143, 161 and 162.

The case now presented includes the following elements.

The petitioner constructed the buildings in question solely for war uses. It had no use for them for its normal peace-time business and had not been making any money in that business (Special Findings 43, 46, R. 77–78).

It constructed these buildings on leased land under an agreement that they should revert to the landlord at the end of the lease on December 31, 1924. Their usefulness to the petitioner was therefore bound to end by that definite date at the latest (Special Finding 44, R. 77).

These new buildings were all used by the petitioner up to the time of the Armistice and the petitioner had orders up to that time to its capacity and had no way of knowing when the demand for ammunition for war purposes would stop (Special Finding 47, R. 79). For that reason the petitioner was unable, up to the year 1918, to charge off in any year more than a proportionate part of the cost based on the charging off the total cost by December 31, 1924.

After the Armistice and as a result of it, the petitioner's officers had no expectation of continuing the manufacture of ammunition for war purposes for which the buildings had been built, and received no new orders for military ammunition and did not expect any (Special Finding 47, R. 79).

No income could be derived by renting the new buildings as there was no demand for buildings of this character (Special Finding 51, R. 81).

The new buildings had been so incorporated into the buildings rented by the petitioner from its landlord that the two had to be used as a unit unless the plant was revamped, and this was not considered or done (Special Finding 51, R. 81).

In an effort to get some return out of the buildings during the last six years of the lease (1919–1924) the petitioner used

them in its commercial (peace-time) ammunition business and for certain other new businesses which it attempted to carry on. None of these businesses proved profitable and the petitioner obtained no net return from these attempts to use the buildings (Special Finding 51, R. 81).

The depreciated cost of the buildings at the beginning of 1918 was $605,391.75. At the end of 1918 the actual value of the right to use the buildings for the remainder of the lease did not exceed $190,969.86 (Special Findings 49, 53, R. 79, 82).

Under these circumstances the petitioner charged off on its books for the year 1918 the difference between the depreciated cost, $605,391.75, and the residual value of its property, $190,969.86, or $414,421.89, and claimed a deduction of this amount in its income tax returns. The Commissioner of Internal Revenue ruled that the petitioner was not entitled to this allowance because it had not abandoned the buildings or permanently devoted them to a radically different use. He therefore allowed only $86,484.54 for depreciation of the buildings for 1918. This allowance was based on charging off an equal amount each year throughout the lease and took no account whatever of the change in conditions which resulted from the Armistice (Special Finding 49, R. 79–80). The result of the Commissioner's method is to allocate to the war years (1915–1918) $283,592.28, or 35% of the cost of the buildings, and to the later years $518,907.21 of this cost. The method used by the petitioner allocates $611,529.63, or about 76% of the cost to the war years and $190,969.86, or about 24% to the later years. In view of the facts that these buildings were built solely for war production and the petitioner at the time had no other use for them (Finding 46, R. 78) it is apparent that the latter method is more reasonable. An accurate accountant or business man would certainly charge off enough of the cost of such buildings at the end of 1918 so that they would be carried on the books for no more than their real value for peace-time purposes. The Court of Claims specifically found

that the value of the right to use the buildings for the remainder of the lease after December 31, 1918, did not exceed $190,969.86 (Special Finding 53, R. 82). Nevertheless, the Court sustained the Commissioner in allocating deductions to various years on a purely proportionate basis. The reasons assigned by the Court are discussed in connection with the points stated below.

1. The decision of the Court of Claims is inconsistent with the case of Burnet v. Niagara Falls Brewing Co., 282 U. S. 648, which is an authority in favor of the deduction claimed.

In *Burnet* v. *Niagara Falls Brewing Co.*, it was held that a corporation engaged in making beer was entitled to an allowance for obsolescence of its brewery buildings arising from national prohibition, although the company continued to use them in making soft drinks after prohibition went into effect. This case is similar in all essential respects to the case at bar.

The opinion of the Court of Claims distinguishes the *Niagara Falls Brewing Co.* case on the ground that that case was one where use of the buildings for the purposes intended was prohibited by law and the buildings were "not readily adaptable to other uses" (R. 108–109). It is submitted that this distinction is not sound. The opinion in the *Niagara Falls Brewing Co.* case clearly treats loss of trade as one of the changes which may result in obsolescence and also shows that the buildings in that case were adaptable to making soft drinks. (See opinion in *Burnet* v. *Niagara Falls Brewing Co.* 282 U. S. 648 at pages 652, 654.)

Another reason advanced by the Court of Claims is that the allowance of annual depreciation made by the Commissioner would eventually return the cost of the buildings and therefore no other allowance for obsolescence was necessary (R. 106, 109). This reasoning fails to distinguish between the ordinary allowance made on a time basis (depreciation and exhaustion) and obsolescence, which is a more rapid loss of value caused by change of circumstances. A tenant who erects buildings on

leased land which will become the property of the landlord at the end of the lease is entitled to proportionate annual allowances for exhaustion.

> *Duffy* v. *Central R. R. Co. of New Jersey*, 268 U. S. 55, cf. Art. 109, Regulations 45, printed at page 104 of record.

That is the nature of the allowance which was made in the case at bar by the Commissioner of Internal Revenue. The Commissioner and the Court of Claims have made no allowance for the complete change in the trade caused by the end of the war in advance of the time when allowances for "exhaustion" would equal the cost. *Burnet* v. *Niagara Falls Brewing Co.* is a clear authority for the allowance of obsolescence in the year in which property ceases, because of changes in trade, to be useful for the purposes for which it was built or acquired. It was undoubtedly true in that case that if no obsolescence had been allowed, the taxpayer might eventually have obtained allowances equivalent to the cost of its buildings through losses incurred on sales or through ordinary depreciation. That did not prevent the allowance of obsolescence, and should not prevent it in the case at bar.

Another reason relied on by the Court of Claims is that obsolescence should not be allowed when buildings are continued in use by their owner (Opinion, R. 105–109). It is submitted that this reasoning is entirely inconsistent with the decision in the *Niagara Falls Brewing Co.* case. In reply to the contention that obsolescence begins only when there is a reasonable certainty that the property cannot be used by the owner *for any purpose*, the opinion in the *Niagara Falls Brewing Co.* case states, "There is no hard and fast rule, as suggested by the Government, that a taxpayer must show that his property will be scrapped or cease to be used or useful for any purpose, before any allowance may be made for obsolescence . . . The company was unable to find any profitable use to which the prop-

erty could be put. The sums received on the sale and as rents constituted mere salvage." (See Opinion, 282 U. S. 648, at pp. 655, 656.) The decision in that case allowed obsolescence on a brewery although it was used after 1919 for making near beer and soft drinks and was subsequently rented.

The Commissioner of Internal Revenue cannot by regulations or otherwise lawfully impose a condition as to abandonment which is not found in the statute.

United States v. *George*, 228 U. S. 14.
International Railway Co. v. *Davidson*, 257 U. S. 506.
Campbell v. *Galeno Chemical Co.*, 281 U. S. 599, 610.

The Court of Claims also relied on a number of decisions of the Board of Tax Appeals (R. pp. 106–108). The objection to the use of these decisions as authorities is that they represent a line of cases inconsistent with the decision of this Court in the *Niagara Falls Brewing Co.* case. It should be noted that the *Niagara Falls Brewing Co.* case originated in the Board of Tax Appeals, and was there decided adversely to the taxpayer on the ground that no allowance for obsolescence on brewery property could be made where it was continued in use by the taxpayer after prohibition. (See *Niagara Falls Brewing Co.* 13 B.T.A. 1040 at 1049.) Prior decisions of the Board of Tax Appeals based on a similar rule were

Yough Brewing Co., 4 B.T.A. 612.
Star Brewing Co., 7 B.T.A. 377.
Tennessee Fibre Co., 15 B.T.A. 133.
Marigold Garden Co., 6 B.T.A. 368.
McCabe Lathe & Machinery Co., 9 B.T.A. 1137.

It would seem that until the Board of Tax Appeals has rendered a decision with respect to obsolescence which takes into account the decision of this Court in the *Niagara Falls Brewing Co.* case, citations from opinions of the Board of Tax Appeals on the issue now presented cannot be of assistance.

2. The fact that the petitioner's buildings became obsolete for the purpose for which they were built within a single tax year is not a bar to the deduction claimed.

It is not conceivable that Congress meant to give a deduction to a taxpayer who sustained a loss which occurred partly in one year and partly in another, and to deny such a deduction to another taxpayer who had a similar loss which all happened within one year. There was undoubtedly a period of several weeks before the Armistice in which it was apparent that the end of the war was near. It happened that this period fell entirely within the months of September, October and November, 1918. It might well have happened that the period would have included December, 1918, and January, 1919. There is no reason for applying different rules in the two cases. Obsolescence which ripens into obsoleteness within a single tax year is as clearly within the language of section 234 (a) (4) and (7) as is similar obsolescence which begins in one year and ripens into obsoleteness in the succeeding one.

3. The allowances made by the Commissioner of Internal Revenue in the years 1919–1924 on account of the cost of the buildings are not a bar to relief.

In the Court below it was argued for the respondent that if the petitioner should now obtain the allowances claimed for 1918 there would be a double deduction, as the Commissioner allowed for the years 1919–1924 deductions aggregating the amount which he disallowed for 1918. This argument ignores the findings that the allowances for later years were not claimed by the petitioner but were made by the Commissioner on his own motion as a result of his disallowances of the claim made for the year 1918; and that when he made this disallowance for 1918, the taxes for all the later years were still open, as the petitioner had waived the statute of limitations (Special Finding 49, R. 80–81). The state of affairs which now exists was one which the Commissioner deliberately created with all

the facts before him. He allowed these deductions in years when the rates of tax were so low that they made very little difference to the petitioner, and disallowed an equivalent deduction in 1918 when the taxes involved amounted to 82.4% of the deduction. The Commissioner could not, by forcing upon the petitioner deductions in later years which were not asked for, deprive the petitioner of a deduction to which it was entitled in 1918. Furthermore, the petitioner has no intention of obtaining a double deduction. Counsel was authorized to state, and did state in writing in the Court below, that if the deduction claimed for 1918 was finally established and a corresponding refund of taxes obtained, the petitioner would pay or cause to be paid such added amounts of tax, if any, as might be due for later years (either under the petitioner's returns or under consolidated returns which include the petitioner's income) because of any restatement of such deductions for later years which might be necessary in order to avoid duplication of the same allowance. Under this offer it is to be understood that in case taxes for later years have been finally settled, those years are to be opened up only as to items which the final judgment in this suit would result in changing and only to the extent that changes in such items are required as a result of such judgment.

B. Certiorari should be granted to correct the decision of the Court below with respect to the valuation of inventories under the contracts with the United States which were suspended.

The statute involved is section 203 of the Revenue Act of 1918 which reads as follows:

> "That whenever in the opinion of the Commissioner the use of inventories is necessary in order clearly to determine the income of any taxpayer, inventories shall be taken by such taxpayer upon such basis as the Commis-

sioner, with the approval of the Secretary, may prescribe as conforming as nearly as may be to the best accounting practice in the trade or business and as most clearly reflecting the income."

The material regulations are regulations 45, articles 22–24 and 1582–1584 (as amended by Treasury Decision 3296); and regulations 65, articles 1612–1614 (identical with said articles 1582–1584) and article 50. The material portions of these regulations are printed below at pp. 21–24. The facts with reference to the question now presented are stated in the petition at pages 5–10 of the printed record. These facts, together with the statutes and regulations referred to, establish the following propositions.

1. On December 31, 1918, this inventory did not include anything which was to be used to make such completed articles as were called for by the contracts.

The articles to be delivered under the contracts were cartridges and artillery primers. The inventories in question included only raw materials and work in process which were not needed in order to complete the limited number of finished articles which the suspension requests permitted the petitioner to furnish. (Special Findings 23–24, R. 69–70.)

2. On December 31, 1918, the petitioner had no contracts with the United States by which the United States agreed to accept these inventories and to pay for them at cost.

The opinion of the Court of Claims was apparently written in a belief to the contrary. The Court below states

> "The United States contracts clearly disclose 'firm sales contracts at fixed prices' and while the contracts were subject to cancellation, they contained express covenants upon the part of the United States to save the plaintiff

harmless in so far as the cost of materials, etc., entering into its inventory is concerned. The contracts contained express provisions setting forth with exactness how the plaintiff should be paid, and the items included within the Government's liability to pay (R. 97–98).

In reaching this conclusion the Court of Claims has overlooked the terms of the original contracts and of the suspension requests and the decision of this Court in *College Point Boat Corporation* v. *United States*, 267 U. S. 12. The contracts are listed on page 6 of the printed record. Copies are printed in the record beginning at pages 120, 132, 134, 146 and 163. The respective cancellation clauses of the contracts are printed at pages 125 (Art. V), 134 (Art. IV), 141 (Art. XIV), 153 (Art. VII) and 170 (Art. XIV). The suspension requests are printed as exhibits E, F, G and H at pages 52–56. The cancellation clauses gave the petitioner valuable rights in the event that the Chief of Ordnance elected to cancel the contracts (R. 6). The facts which are stated in the petition for certiorari at pages 6–7 of the printed record, clearly show that the Chief of Ordnance did not exercise the rights given by the cancellation clauses, but on the contrary expressly stated in the several suspension requests that these requests were made with a view to *negotiation of supplemental contracts* providing for the cancellation (or modification) of the existing contracts "*in a manner which will permit of a more prompt settlement and payment than will be practicable under the terms of said existing contract.*" (Italics ours. See suspension requests, R. 52–56.) The petitioner complied with the suspension requests (Special Finding 22, R. 69). As the original contracts contained no provisions for delivery of unfinished articles, except the cancellation clauses, and as the options to cancel were not exercised, it is impossible to support the conclusion of the Court of Claims that the settlements which were made involved merely the carrying out of the terms of the original contracts. *College*

Point Boat Corporation v. *United States*, 267 U. S. 12, is a conclusive authority against the proposition that these suspension requests exercised the options to cancel which were contained in the original contracts. (See petition for certiorari, at R. 13.)

3. On December 31, 1918, it was wholly uncertain whether the petitioner would reach any settlements of its contracts and whether, if it did, the settlements would involve the taking over of the inventories and payment for them at cost.

It is expressly found that on December 31, 1918, there was no way in which the petitioner could get cost for the inventories in question except by settlements with the United States. The materials were not salable at cost or at anything approaching cost (Special Finding 24, R. 70).

The suspension requests plainly contemplated negotiations looking toward some form of compensation to the petitioner on account of the cancellation of further deliveries. At the end of the year 1918 no one could know what form any settlements would take with respect to inventories, or whether the parties to a given contract would agree on a settlement.

Nothing happened in 1918 which gave the petitioner any assurance that the settlements, if made, would include the acceptance of the inventories by the Government and payment for them at cost. It was clear that the War Department did not want any more ammunition. There was nothing at the time to indicate that the War Department would adopt the policy which was later followed of taking over the enormous quantities of materials for ammunition which the various contractors had on hand, and setting up elaborate machinery for disposing of these materials, rather than leaving the materials in the hands of the contractors and making negotiated settlements with them as to their losses.

It is also to be noted that it was not until after 1918 that the War Department adopted a policy which permitted a partial

settlement for an inventory where the parties had not reached a complete settlement of a contract.

The date when the War Department adopted the policy of partial settlements for inventories was March 6, 1919 (Special Finding 26, R. 70). As the petitioner had important claims under each of the contracts in addition to those relating to its inventories, and as, at the end of 1918, it was wholly uncertain whether the parties would ever agree as to the settlement of any of these other claims, the prospects at that time for a settlement of its inventory claims were equally uncertain.

In the event that the petitioner was unable to agree with the War Department as to the terms of the settlement of any contract, its remedy, if any, would be only by suit in the Court of Claims for breach of contract. The Comptroller of the Treasury and the Comptroller General could not settle such complicated, unliquidated claims for breach of contract.

Power v. *United States*, 18 C. Cls. 263.

In any such suit it is clear that the judgment would not be that the United States should take the inventories and pay cost for them, but the petitioner would keep the inventories and, if it prevailed, would obtain a judgment for a sum of money to cover the petitioner's loss because the United States had failed to accept and to pay for the completed articles specified in the contracts.

United States v. *Behan*, 110 U. S. 338.
United States v. *United States Fidelity & Guaranty Co.*, 236 U. S. 512, 525.
Guerini Stone Co. v. *Carlin Construction Co.*, 248 U. S. 334, 343.

Furthermore there was doubt at the time and for several years afterwards as to whether the petitioner could treat a suspension request as a breach of contract where it had as-

sented to the request. The earlier decisions of the Court of Claims increased this doubt.

> *Dorris Motor Car Co.* v. *United States*, 60 C. Cls. 68, 78.
> *Savage Arms Corporation* v. *United States*, 57 C. Cls. 71, 85–86.

It was only after the decision of this Court in *College Point Boat Corporation* v. *United States*, 267 U. S. 12, which was handed down in January, 1925, that there was clear authority for treating such a request as a breach of contract in case negotiations failed.

4. Up to the time of the partial settlements made in 1920 the petitioner had no agreement that its inventories would be taken over and paid for at cost; and up to the time of the final settlements made in 1921–1922, the amount which the petitioner was to be paid was unliquidated.

The first proposition in this conclusion follows from the points which have already been stated and the last from the facts relating to the negotiations for settlement which are found in the petition for certiorari at pages 8–10 of the record. These facts show that on more than one occasion it appeared that any settlement of the petitioner's claims through the War Department was improbable, and that up to the time of the final settlements the amount of the claims was unliquidated.

5. Under the circumstances which have been stated the inventories should have been valued at their market value on December 31, 1918, ($231,615.43) and not at the amount ($732,088.62) which was realized for them in later years through the settlement agreements.

It is apparent from what has already been stated that what the petitioner had on December 31, 1918 was (1) inventories worth as merchandise $231,615.43, and in addition (2) claims for a much larger amount for reimbursement for the differ-

ence between the cost of its inventories and what they were worth as merchandise. The petitioner's chances for such reimbursement depended either on negotiations or on the outcome of a suit in the Court of Claims. As has been shown above, there was, on December 31, 1918, no ground for assurance as to the result of either negotiations or law suits. The petitioner contends that the Commissioner of Internal Revenue was not justified in valuing this merchandise as of December 31, 1918 at a figure which included its then present value plus the additional amounts eventually realized through the negotiation for the cancellation of the contracts.

a. The income which Congress intended to tax by the Revenue Act of 1918 was income which was so realized as to be available to the taxpayer according to ordinary business usage, and the petitioner's inventories were so available only at their market value.

The Revenue Act of 1918 imposed taxes running up to 82.4% of net income, which were payable during the year 1919. The inference is plain that Congress expected that taxpayers would have the income on hand out of which the taxes might be paid. It follows that the income intended to be taxed was something which, according to ordinary business practice, could be used to raise money with which to pay the taxes. Otherwise the result of the tax would in many cases be bankruptcy. The inventories in question were available at their market value for this purpose, as a basis for credit or by sale. They were not available at a price which included the additional amounts realized by the settlements which were made in later years.

b. The system of taxation contained in the Revenue Act of 1918 is based on an annual accounting period; and the petitioner's inventories should therefore be taken at their value at the end of 1918.

The decision of the Court of Claims was apparently based on the theory that the amount of the petitioner's taxes for 1918 might properly be kept open during the period of the statute of limitations and settled in the light of what the assets brought in later years within that period (See Opinion, R. 99–100). In support of this theory the Court relied on *Producers Fuel Co.*, 1 B.T.A. 202.

The objections to this treatment of the case at bar are that the Court below overlooked the general rule that taxes must be determined according to what takes place in the tax year, and also overlooked the fact that the *Producers Fuel Co.* case is only a narrowly limited exception to this rule, and does not apply to the facts in the present case.

The general rule is stated as follows in a recent opinion of the Supreme Court:

> "The Federal income tax system is based upon an annual accounting period. This requires that gains or losses be accounted for in the year in which they are realized.
>
> *Lucas* v. *Kansas Structural Steel Co.*, 281 U. S. 264, 268."

A later decision to the same effect is *Burnet* v. *Sanford & Brooks Co.*, 282 U. S. 359.

Producers Fuel Co., 1 B.T.A. 202, was a case in which a purchaser repudiated a contract to buy goods in December, 1920, and in the same month admitted liability for the breach, began negotiations for settlement and set up a reserve for the amount of the damages. Settlements were made in January, 1921, by which the amounts to be paid were somewhat less than the reserve. The Board of Tax Appeals held that the purchaser might deduct a loss in 1920 but must substitute the amounts actually agreed on in settlement for the amount of the reserve. The decision has been limited to its special facts

by later cases in the Board of Tax Appeals which the Court below did not notice. The limited scope of the decision is recognized in *Lucas* v. *American Code Co.*, 280 U. S. 445 at pp. 449–450, as follows:

> "The Board of Tax Appeals has held, in a series of well-reasoned opinions, that a loss occasioned by the taxpayer's breach of contract is not deductible in the year of the breach, except under the special circumstances where, within the tax year, there is a definite admission of liability, negotiations for settlement are begun, and a reasonable estimate of the amount of the loss is accrued on the books."

The cases in the Board of Tax Appeals are collected in a footnote to the same opinion at page 450. It is clear that the *Producers Fuel Co.* case does not support the doctrine that an inventory may be valued at the end of a given year according to what is obtained for it in later years.

c. The decision of the Court of Claims is inconsistent with good accounting practice, which is recognized by the Revenue Act of 1918 and by the regulations as a standard.

The material portion of the Revenue Act of 1918 is section 203 which reads as follows:

> "That whenever in the opinion of the Commissioner the use of inventories is necessary in order clearly to determine the income of any taxpayer, inventories shall be taken by such taxpayer upon such basis as the Commissioner, with the approval of the Secretary, may prescribe as conforming as nearly as may be to the best accounting practice in the trade or business and as most clearly reflecting the income."

The regulations involved are Regulations 45, arts. 22–24 the material portions of which are as follows:

"Art. 22. Computation of net income.— Net income must be computed with respect to a fixed period. Usually that period is twelve months and is known as the taxable year . . . The time as of which any item of gross income or any deduction is to be accounted for must be determined in the light of the fundamental rule that the computation shall be made in such a manner as clearly reflects the taxpayer's income . . ."

"Art. 23. Bases of computation.—(1) Approved standard methods of accounting will ordinarily be regarded as clearly reflecting income . . ."

"Art. 24. Methods of accounting.— It is recognized that no uniform method of accounting can be prescribed for all taxpayers, and the law contemplates that each taxpayer shall adopt such forms and systems of accounting as are in his judgment best suited to his purpose. . . .

(1) In all cases in which the production, purchase or sale of merchandise of any kind is an income-producing factor inventories of the merchandise on hand (including finished goods, work in process, raw materials and supplies) should be taken at the beginning and end of the year and used in computing the net income of the year; . . ."

The provisions quoted clearly state the following propositions: (1) that it is the income *realized by the taxpayer within the taxable year* which is to be taxed; and (2) that standard accounting practice is ordinarily to be followed in determining this income.

According to standard accounting practice, inventories are a part of the quick assets of a manufacturing corporation. The excess of quick assets over current liabilities constitutes its working capital. The principal purposes of taking inventories and including them among quick assets are to give in-

formation to the management in laying out a financial policy; to give information concerning profits earned as a basis for dividends; and to give information to creditors as to what the company has with which to meet their claims. These purposes require that inventories should be treated as something which may be expected to be converted into current funds within a reasonable time for turnover. One of the principal reasons for listing quick assets separately is that creditors have as much right to know the availability of funds for meeting their debts when due as they have to know the ultimate value of the debts. If the officers of the petitioner had applied to a bank for a loan on December 31, 1918, and had obtained it on a statement that the inventories on hand, taken on the basis of "cost or market whichever is lower" were worth $732,088.62, knowing that they were worth as merchandise only $231,615.43, could the transaction be defended as honest? It is submitted that these inventories should be valued on the same basis for income tax purposes as for other purposes.

d. The decision of the Court of Claims is contrary to the particular provisions of the regulations which relate specifically to the valuation of inventories and to the proceeds of the settlement of claims on Government contracts.

The regulations involved are Regulations 45, articles 1582–1584 as amended by Treasury Decision 3296, and Regulations 65, article 50, which was in force when the petitioner's tax was determined in 1926. Articles 1582–1584 of Regulations 45 are identical with articles 1612–1614 of Regulations 65 which are printed in full as a part of the petition filed in the Court of Claims (R. 19–23). The portions of these regulations which have a direct bearing on the issue are as follows:

> "Art. 1582. Valuation of inventories.— The Act provides two tests to which each inventory must conform: (1) It must conform as nearly as may be to the best accounting practice in the trade or business, and (2) it must

clearly reflect the income . . . An inventory that can be used under the best accounting practice in a balance sheet showing the financial position of the taxpayer can, as a general rule, be regarded as clearly reflecting his income.

"The basis of valuation most commonly used by business concerns and which meets the requirements of the Revenue Act is (a) cost or (b) cost or market, whichever is lower. (For inventories by dealers in securities, see article 1585.) Any goods in an inventory which are unsalable at normal prices or unusable in the normal way because of damage, imperfections, shop wear, changes of style, odd or broken lots, or other similar causes, including second-hand goods taken in exchange, should be valued at bona fide selling prices less cost of selling whether basis (a) or (b) is used, or if such goods consist of raw materials or partly finished goods held for use or consumption, they shall be valued upon a reasonable basis, taking into consideration the usability and the condition of the goods, but in no case shall such value be less than the scrap value . . .

"Art. 1584. Inventories at market.—Under ordinary circumstances, and for normal goods in an inventory, 'market' means the current bid price prevailing at the date of the inventory for the particular merchandise in the volume in which usually purchased by the taxpayer, and is applicable in the case (a) of goods purchased and on hand, and (b) of basic elements of cost (materials, labor, and burden) in goods in process of manufacture and in finished goods on hand; exclusive, however, of goods on hand or in process of manufacture for delivery upon firm sales contracts (i.e., those not legally subject to cancellation by either party) at fixed prices entered into before the date of the inventory, which goods must be inventoried at cost . . ."

The material portion of article 50 of Regulations 65 reads as follows:

> "Art. 50. When included in gross income.—Gains, profits and income are to be included in the gross income for the taxable year in which they are received by the taxpayer, unless they are included when they accrue to him in accordance with the approved method of accounting followed by him. See articles 21–24. If a person sues in one year on a pecuniary claim or for property, and money or property is recovered on a judgment therefor in a later year, income is realized in that year, assuming that the money or property would have been income in the earlier year if then received . . . *Such items as claims for compensation under canceled Government contracts constitute income for the year in which they are allowed or their value is otherwise definitely determined.*" (Italics ours.)

It is submitted that the regulations required the petitioner's inventories to be valued at their market value on December 31, 1918. In the Court below the respondent relied on article 1584 as supporting the Commissioner's valuation, claiming that the "firm sales contract" exception found in that article applied, that the cost of the goods was received in the settlements, and that therefore the regulations had been followed in effect by valuing the goods at the amounts so received. The Court of Claims, having first assumed that the *original contracts* entitled the petitioner to receive cost for these inventories (an erroneous assumption—see this brief, pp. 13–15), treated the case as one of "firm sales contracts" (R. 97). It is submitted that the regulations are to the contrary.

In the first place, article 1584, in which the "firm sales contracts" exception is found, applies only to *normal* goods. As appears from the preceding article, 1582, "normal" goods are those which are salable at normal prices or usable in the normal

way. The petitioner's inventories were not "normal" goods; for the suspension requests had cut off all probability of using them in the normal way.

In the second place, the "firm sales contracts" exception in art. 1584, by its own terms, applies only to "goods on hand or in process of manufacture for delivery upon firm sales contracts (i.e. those not legally subject to cancellation by either party) at fixed prices entered into before the date of the inventory, . . ." The inventories in question differ from those described in this article in three respects:

1. They were not goods on hand *for delivery*; for at the end of the year 1918 the parties knew that they would never be made into finished articles, and whether the United States would take delivery of them as a part of the settlement of the contracts was wholly uncertain. (See this brief, pp. 13–17.)

2. On December 31, 1918, the contracts were not "firm sales contracts" as defined by article 1584 in the words "those not legally subject to cancellation by either party." Performance under every contract had been cancelled by agreement. If, as the regulations recognize, even an unexercised right to cancel destroys the exception, accomplished suspension of production is certainly inconsistent with a "firm sales contract."

3. The contracts as they apply to these inventories were not contracts "at fixed prices entered into before the date of the inventory." The only contracts in existence on December 31, 1918, which called for delivery of goods at fixed prices were the original contracts, and the goods which they called for were completed articles. The cancellation clauses which might have applied to the inventories were inoperative, as has been shown above. (See this brief, pp. 13–15.) In the events which happened, the only contracts which provided for the payment for these materials at fixed prices were the settlement contracts made in 1920–1922. These were not made "before the date of the inventory."

Furthermore, the possible claims which the petitioner had

on account of the failure of the respondent to perform the original contracts are, under the regulations, clearly not income in 1918. Article 50 of Regulations 65, which was in force when the petitioner's taxes were settled, expressly provided:

> "*Such items as claims for compensation under canceled Government contracts constitute income for the year in which they are allowed or their value is otherwise definitely determined.*" (Italics ours.)

This article is clearly in accord with the plan of taxation on which the revenue acts are based, as appears from a recent decision of this Court.

Burnet v. *Sanford & Brooks Co.*, 282 U. S. 359.

On December 31, 1918, the petitioner had inventories worth as merchandise $231,615.43, plus possible claims for breach of contract the value of which was uncertain. (See this brief, pp. 15–17.) By valuing these inventories at $732,088.62, the Commissioner included in income for the year 1918 $500,473.19 which was nothing but the proceeds of claims for the cancellation of the contracts which were not liquidated or settled until several years later. Under article 50 these proceeds should have been included in the income for later years and not in 1918 income.

e. The argument that valuing the inventories at market permits the petitioner to take a loss before it is sustained is not valid.

The objection to this argument is that it overlooks the distinction between inventories, which, according to the best accounting practice as exemplified in the "cost or market whichever is lower" method, should be brought down annually to actual current values, and capital assets, which should be carried at cost less depreciation (or exhaustion or obsolescence)

until they are sold or otherwise disposed of. The very purpose of the regulations in permitting the use of the "cost or market" valuation of inventories is to give the taxpayer the right to value them at prices less than cost when the market value is below cost.

C. The statutes and regulations should be liberally construed in favor of the taxpayer.

In the case at bar it is submitted that the statutes and regulations sustain the petitioner's contentions. If any doubt arises, however, they should be liberally construed in favor of the taxpayer (*Burnet* v. *Niagara Falls Brewing Co.*, 282 U. S. 648, at 654, and cases cited). It is respectfully submitted that the Court of Claims failed to observe this principle of construction.

D. The questions involved are of general importance.

The principles on which the decision of the case at bar must depend are of wide application. They apply as fully to the revenue acts subsequent to the Revenue Act of 1918 as they do to that act. Changes in industry are constantly compelling taxpayers to stop using property for the special purposes for which it was acquired. It is important that it should be settled by a decision of this Court whether a taxpayer who continues to use such property in order to get some return out of it loses all right to an allowance for obsolescence. The decision of the Court of Claims, unless it is reviewed by this Court, will leave both taxpayers and the Treasury Department in doubt as to allowances for obsolescence in cases where prohibitory statutes are not involved.

Questions like those involved in the valuation of the petitioner's inventories also affect a large number of taxpayers. Particularly in times of falling prices like the present persons engaged in trading or manufacturing are likely to have con-

tracts for the sale of goods which the purchasers are not willing to perform. It is important that the correct rule as to the valuation of inventories acquired for use in fulfilling such contracts should be settled by a decision of this Court. It is also of great importance in the administration of the tax laws that this Court should decide whether (as the Court of Claims has apparently decided) tax returns may be kept open and taxes determined according to events which happen in later years, or whether taxes must be assessed on the facts which exist at the end of the tax year.

VI.

Conclusion.

It is respectfully submitted that for the reasons stated in the petition for certiorari and in this brief this case calls for the exercise by this Court of its supervisory powers, in order that the construction of the revenue act in question and of later similar acts may be settled, that the conflict may be removed between the decision of the Court of Claims in the case at bar and the decisions of the Supreme Court of the United States which have been referred to in this brief, and that the petitioner may be relieved from a tax which largely exceeds its entire net income for the year 1918, if its income is determined in accordance with the evident purpose of the statute; and that accordingly the writ of certiorari should be granted.

HARRY LEBARON SAMPSON,
Counsel for the Petitioner.

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DEC 28
CHARLES ELMORE

Supreme Court of the United States.

OCTOBER TERM, 1931.

No. 348

UNITED STATES CARTRIDGE COMPANY Petitioner,

v.

THE UNITED STATES.

BRIEF FOR UNITED STATES CARTRIDGE COMPANY, Petitioner.

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INDEX.

PAGE

I. Opinion of the Court Below 1

II. Jurisdiction of this Court 1

III. Statement of the Case 2

IV. Specification of Errors 14

V. Summary of Argument 15

VI. Argument 17

A. In determining the petitioner's taxes for the year 1918, the deduction of $327,937.35 claimed by the petitioner on account of the cost of buildings erected for war purposes on leased land should have been allowed. 17

(1) The decision in the case of *Burnet* v. *Niagara Falls Brewing Co.*, 282 U. S. 648, supports the deduction which is claimed by the petitioner 20

(2) The fact that the petitioner's buildings became obsolete for the purpose for which they were built within a single tax year is not a bar to the deduction 24

(3) The allowances made by the Commissioner of Internal Revenue in the years 1919–1924 on account of the cost of the buildings are not a bar to relief . . 25

B. The petitioner's inventories acquired for use under its contracts with the United States should have been valued on December 31, 1918, at their market value, $231,615.43 27

(1) On December 31, 1918, it was wholly uncertain what would become of these inventories and the petitioner had no contracts under which it was entitled to deliver these inventories and to be paid for them 28

(a) On December 31, 1918, these inventories did not include anything which was to be used to make such completed articles as were called for by the contracts 28

PAGE

(b) On December 31, 1918, the petitioner had no contracts with the United States by which the United States agreed to accept these inventories and to pay for them at cost 28

(c) On December 31, 1918, it was wholly uncertain whether the petitioner would reach any settlements of its contracts and whether, if it did, the settlements would involve the taking over of the inventories and payment for them at cost . . 33

(d) Up to the time of the partial settlements made in 1920 the petitioner had no agreement that its inventories would be taken over and paid for at cost, and up to the time of the final settlements made in 1921–1922, the amount which the petitioner was to be paid was unliquidated . . . 35

(2) Under the circumstances which have been stated the inventories should have been valued at their market value on December 31, 1918, ($231,615.43) and not at the amount ($732,088.62) which was realized for them in later years through the settlement agreements 36

(a) The income which Congress intended to tax by the Revenue Act of 1918 was income which was so realized as to be available to the taxpayer according to ordinary business usage and the petitioner's inventories were so available only at their market value 36

(b) The system of taxation contained in the Revenue Act of 1918 is based on an annual accounting period; and the petitioner's inventories should therefore be taken at their value at the end of 1918 37

(c) According to good accounting practice, which is recognized by the Revenue Act of 1918 and by the regulations as a standard, these inventories should be valued at their market value. 39

PAGE

(d) The regulations which relate to the valuation of inventories and to the proceeds of the settlement of claims on Government contracts require that these inventories be valued at their market value 42

(e) The argument that valuing the inventories at market permits the petitioner to take a loss before it is sustained is not valid 47

C. The statutes and regulations should be liberally construed in favor of the taxpayer. 48

VII. The amount of interest to which the petitioner is entitled 48

Conclusion 49

CASES CITED.

PAGE

Burnet *v.* Niagara Falls Brewing Co., 282 U. S. 648 . . 20, 48
Burnet *v.* Sanford & Brooks Co., 282 U. S. 359 . . .38, 46, 47
Burton Coal Co. *v.* United States, 60 C. Cls. 294 32
Campbell *v.* Galeno Chemical Co., 281 U. S. 599 . . . 23
College Point Boat Corporation *v.* United States, 267 U. S. 12 . . . . . 29, 31, 35
Crown Mfg. Co. *v.* Commissioner, 12 B. T. A. 37 . . . 39
Dorris Motor Car Co. *v.* United States, 60 C. Cls. 68 . 35
Duffy *v.* Central R. R. Co. of New Jersey, 268 U. S. 55 22
Guerini Stone Co. *v.* Carlin Construction Co., 248 U. S. 334 35
International Ry. Co. *v.* Davidson, 257 U. S. 506 . . . 23
Lucas *v.* American Code Co. Inc., 280 U. S. 445 . . . 38
Lucas *v.* Kansas City Structural Steel Co., 281 U. S. 264 38
Marigold Garden Co., 6 B.T.A. 368 24
McCabe Lathe & Machinery Co., 9 B.T.A. 1137 . . . 24
Niagara Falls Brewing Co., 13 B.T.A. 1040 24

PAGE

Power *v.* United States, 18 C. Cls. 263 34
Producers Fuel Company, 1 B.T.A. 202 . . . . . 37, 38
Savage Arms Corporation *v.* United States, 57 C. Cls. 71. 35
Star Brewing Co., Inc., 7 B.T.A. 377 24
Tennessee Fibre Co., 15 B.T.A. 133 24
United States *v.* Behan, 110 U. S. 338 35
United States *v.* George, 228 U. S. 14 23
United States *v.* United States Fidelity & Guaranty Co., 236 U. S. 512 35
Valente *v.* Weinberg 80 Conn., 134 32
Yough Brewing Co., 4 B.T.A. 612 24

STATUTES AND REGULATIONS CITED.

PAGE

Judicial Code:
Sec. 240 as amended by Act of February 13, 1925 (43 Stat. 936) 1

Revenue Act of 1918 (40 Stat. 1057):
Sec. 203 . . . . . 27, 39
Sec. 234 (a) 17

Revenue Act of 1928, Sec. 615 48

Regulations 45:
Arts. 22–24 . . . . . 27, 40
Art. 109 . . . . . 18, 50
Art. 143 . . . . . 18, 50
Arts. 161, 162, 165 . . . . . 18, 51, 52
Arts. 1582–1584 . . . . . 28, 42

Regulations 65:
Art. 50 . . . . . 28, 44, 46
Arts. 1612–1614 . . . . . 28, 42

A. R. R. 6016, 111–1 C. B. 59 39

Supreme Court of the United States.

OCTOBER TERM, 1931.

UNITED STATES CARTRIDGE COMPANY, PETITIONER.
v.
THE UNITED STATES. } No. 348.

BRIEF FOR UNITED STATES CARTRIDGE COMPANY, Petitioner.

I.

THE OPINION OF THE COURT BELOW.

This case comes before the Court for hearing on the merits on a writ of certiorari issued to review a judgment of the Court of Claims.

The opinion in the Court of Claims is reported in 48 F. (2nd) 983. It is printed at pp. 88–110 of the record in this case.

II.

JURISDICTION OF THIS COURT.

The jurisdiction of this Court is based on the Judicial Code, section 240, as amended by Act of February 13, 1925 (43 Stat. 936). The material portion of this section is as follows:

"(b) In any case in the Court of Claims, including those begun under section 180 of the Judicial Code, it shall be competent for the Supreme Court, upon the petition of either party, whether Government or claimant, to require, by certiorari, that the cause, including the findings of fact and the judgment or decree, but omitting the evidence, be certified to it for review and determination with the same

power and authority, and with like effect, as if the cause had been brought there by appeal."

The petition in the Court of Claims was brought to recover an alleged overpayment of Federal income and profits taxes for 1918 amounting to $843,589.12, with interest. The petitioner alleged that the Commissioner of Internal Revenue had made three errors in computing the petitioner's income for 1918 which resulted in the assessment of excessive taxes for that year. There was, however, but one cause of action and the errors claimed affected merely the amount of the judgment to be entered, if any. The Court made special findings of fact and on those findings ruled in the petitioner's favor with respect to the first of the alleged errors and in favor of the United States with respect to the other two. Final judgment for the petitioner was entered in the Court of Claims on June 10, 1931, for $160,978.83 with interest (R. 200). The amount of this judgment corrected the first alleged error but not the second or the third. The petition for a writ of certiorari was filed on September 3, 1931, and granted on November 23, 1931.

III.

STATEMENT OF THE CASE.

The petitioner alleged in the suit in the Court of Claims that the Commissioner of Internal Revenue (hereafter called "the Commissioner") had made the following errors in determining its taxes for 1918, namely, (1) An error in overvaluing a certain Maxim contract inventory by $195,362.67; (2) An error in overvaluing certain inventories relating to contracts with the United States by $500,473.19; and (3) An error in disallowing $327,937.35 of a deduction claimed on account of the cost of certain buildings erected for war purposes on leased land.

The judgment for the petitioner in the Court below covered the full amount claimed on account of the overvaluation of the Maxim (or Italian) inventory, but nothing more. The petition

for certiorari raises issues bearing on the question as to whether the Court should have entered judgment for a larger sum which would have given relief to the petitioner on account of the other two errors alleged. The amounts of income and taxes involved (exclusive of interest) are shown in the statement which follows. All the taxes assessed have been paid (Findings 3–6, R. 59–60).

Total taxes assessed by Commissioner (Finding 4, R. 59) . . .		$1,152,123.53
Reduction by Court of Claims on account of Maxim inventory (R. 200)		160,978.83
Net tax according to decision of Court of Claims		$991,144.70
Net income as determined by Commissioner (Finding 4, R. 59)	$1,792,432.58	
Reduction in income on account of overvaluation Maxim inventory ($274,659.78–79,297.11 — Finding 20, R. 66)	195,362.67	
Net income according to decision of Court of Claims	1,597,069.91	
Income involved in pending suit:		
Deduction for cost of buildings (Finding 49, R. 79–80) $327,937.35		
U. S. inventory question ($732,088.62–231,615.43 Finding 41, R. 76) 500,473.19		
Sum of these deductions . . .	828,410.54	
Net income, after deducting items in dispute		768,659.37
Amount by which tax according to decision of Court of Claims exceeds entire net income as claimed by petitioner		222,485.33

Excess profits tax credit (Finding 4, R. 59)	$369,464.68
War profits tax credit (Finding 4, R. 59)	461,080.84

Under Revenue Act of 1918, secs. 301(a), 230(a), 236, taxes on all income in excess of the war profits credit ($461,080.84) amount to 80% of such income for the war profits taxes and excess profits taxes, plus 12% of the remaining 20% of such income (or 2.4%) for income taxes, or a total of 82.4% of such income. As the petitioner had income aside from the items in dispute which exceeded the war profits credit, it follows that the amounts of taxes involved in the pending questions are:

Cost of buildings deduction (82.4% of $327,937.35)	$270,220.38
U. S. inventory question (82.4% of $500,473.19) .	412,389.91

The petitioner complied with all requirements as to filing claims for refund and with all other formal requirements, and the right to recover depends only on how the disputed items should be treated in computing the petitioner's income for 1918 (Opinion of the Court, R. 58, 88–89, Special Findings 1–8, R. 58–61, 110a–115; cf. petition, par. 26, R. 41). The facts relating to these items are stated below.

The Deduction on Account of Cost of Buildings Erected on Leased Land.

For many years before the World War began in 1914 the petitioner had been engaged in the manufacture of ammunition for small arms to be used for ordinary peace-time purposes. Its business was of a very modest size, employing between 350 and 400 persons. It was carried on principally in buildings at Lowell, Massachusetts, which the petitioner rented from the Wamesit Power Company. The market for the petitioner's product was limited. Its business was highly competitive and was not profitable during the years 1911 to 1914 inclusive,

before it began production for war purposes (Special Finding 43, R. 77).

For the purpose of filling war orders which the petitioner had received, and expected to receive while the war continued, the petitioner, at its own expense, constructed buildings upon land of the Wamesit Power Company at Lowell and at South Lowell, Massachusetts, under an agreement by which the petitioner was entitled to occupy these buildings free of rent for ten years from January 1, 1915, and at the end of the ten years they should become the property of the Wamesit Power Company. These buildings will be referred to in this brief as the "new buildings." The cost of these buildings to the petitioner was $802,499.49, nearly all of which was spent in 1915 and 1916 (Special Findings 44–45, R. 77–78).

When the petitioner built these buildings it had no use for them except for war purposes. During the World War the petitioner had a large and profitable business in war ammunition, first, for European governments and, later, for the United States. Its employees increased to about 15,000, and the space occupied was about five times what had been required before the war. The petitioner used all the new buildings up to the time when the United States entered the war and during the years 1917 and 1918. Up to the time of the Armistice, November 11, 1918, the petitioner had orders up to its capacity and had no way of knowing when the demand for war ammunition would stop. After the Armistice, the petitioner received no new orders for military ammunition, did not expect any, and did not expect to continue production of military ammunition to any material extent (Special Findings 46–47, R. 78–79).

After the Armistice the petitioner continued its commercial ammunition business. Its position with respect to this business was difficult, as each of the five munition manufacturers in the country had a large excess capacity. The peace-time business differed in essential respects from the war business. The war business came to the manufacturer. There was no

selling to be done. Production was confined to a few types in large volume. In the commercial ammunition business, both in the pre-war and post-war periods, there were a large number of kinds of articles made for all varieties of arms. Competition was severe and keen and the industry was believed to be declining. After 1918 the petitioner made no profit in its manufacture of commercial ammunition during any of the years included in the period of the lease (Special Findings 50–52, R. 81–82).

No income could be derived by renting the new buildings, as there was no demand for them. Most of the buildings originally rented from the Wamesit Power Company had been so incorporated into the new buildings that the two had to be used as united unless the plant was revamped and this was not considered or done. The petitioner had in the new buildings and in those which it rented more space than it needed for its commercial ammunition business. In an attempt to utilize the space which the petitioner found on its hands, it undertook the manufacture in the buildings in question (except a garage) of certain articles which it had not made before the war, including radiators, radiator tubes, phonograph motors, paper boxes and certain other articles, in addition to commercial ammunition. The volume of this new business was small compared with the petitioner's commercial ammunition business. The petitioner made no profit from these other businesses but suffered a loss in each year (Special Finding 51, R. 81).

Among the buildings in question was a garage which the petitioner built for the trucks and automobiles used in its war business. It had no need for the garage before or after its war business. After the war the petitioner attempted to operate this building as a public garage but realized no net return. It was rented to others from October, 1923, until the end of the lease, a period of fifteen months (Special Finding 56, R. 83).

The Commissioner of Internal Revenue allowed depreciation for the years 1914–1917 inclusive on account of the cost of these new buildings, amounting in all to $197,107.74. The depreciated cost of these buildings at the end of 1917 was $605,391.75 (cost, $802,499.49, less depreciation, $197,107.74). In the settlement of its 1918 income and profits taxes, the petitioner claimed that the value on December 31, 1918, of its right to use these buildings for peace-time purposes for the remainder of the lease was $190,969.86. The Court of Claims has found that the value on December 31, 1918, of such right to use the buildings did not exceed this amount (Special Findings 53, R. 82). The petitioner claimed that it was entitled to deduct for the year 1918 the difference between the depreciated cost of said buildings at the end of 1917, $605,391.75, and the residual value at the end of 1918, $190,-969.86, making a deduction of $414,421.89 for the year 1918. The Commissioner refused to allow any deduction for loss of useful value of these buildings, ruling that the petitioner was not entitled to it because it had not abandoned the use of the buildings or permanently devoted them to a radically different use. The Commissioner allowed a deduction of $86,484.54 for the year 1918 on account of the cost of these buildings and disallowed the remainder of the petitioner's claim, namely $327,937.35. The allowances for depreciation made by the Commissioner were calculated at such a rate that at the expiration of the lease the cost of each building would be extinguished in equal annual instalments (Special Finding 49, R. 79).

The effect of the disallowance by the Commissioner of $327,937.35 of the deduction claimed was to increase the petitioner's taxes for 1918 by 82.4% of that amount. (See p. 4 above.)

In its income tax returns for the years 1919–1924, which were the remaining years of the lease, the petitioner claimed deductions on account of the new buildings amounting in all

to $190,969.86, which was the residual value on December 31, 1918, of the right to use the buildings during the remainder of the lease as claimed by the petitioner. The Commissioner, in determining the taxes for the years 1919–1924 increased the deductions claimed for those years by the $327,937.35 which he had disallowed for the year 1918 (Special Finding 49, R. 79–80). The effect of this was to throw this deduction into years in which the petitioner, if it had any taxable income, would be taxed at relatively low rates, and to deprive the petitioner of it for the year 1918 when it made a difference in taxes of 82.4% of the deduction.

The Court of Claims sustained the Commissioner (Opinion of the Court, R. 101–110).

The Inventories Acquired for use under Contracts with the United States.

The petitioner kept its accounts on an accrual basis and duly elected that its inventories should be priced at cost or market whichever was lower (Special Findings 2–3, R. 59).

At the end of the year 1918 the petitioner had on hand a large quantity of raw materials and work in process which had been acquired by the petitioner for use in manufacturing ammunition to be supplied to the War Department under four contracts and a supplementary agreement which are described in Special Finding 21, R. 67–69). Copies of the contracts and agreement (hereinafter called "contracts") are included in the record (pp. 120–174; see index to record p. ii). A list of the contracts follows:

Contract No.	*Date*	*Articles to be delivered*	
P6489–1489Sa	May 6, 1918	60,100,000	.45 caliber cartridges
First supplement to P6489–1489Sa		75,000,000	.45 caliber cartridges
P12289–3034A	July 20, 1918	8,760,000	49-gr. artillery primers
GA-126	Aug. 22, 1917	5,000,000	110-gr. artillery primers
P12621–3124A	July 25, 1918	1,000,000	110-gr. artillery primers

The issue which arose as to these inventories was whether they should be valued at their market value on December 31, 1918, ($231,615.43) or at the amount used by the Commissioner of Internal Revenue in assessing additional taxes upon the petitioner in 1926 ($732,088.62). The Commissioner's valuation represented what the petitioner eventually realized from these inventories as a result of negotiated settlements with the United States made in the years 1920–1922.

Each contract in question contained a cancellation clause by which the Chief of Ordnance had an option to cancel the contract under certain circumstances. If he did so the contracts gave the petitioner certain rights, including the right to receive payment at cost for raw materials and work in process on hand. Under each of these contracts, except the supplement to P6489–1489Sa and GA–126, the petitioner also had the right, if the Chief of Ordnance exercised the option given by the cancellation clause, to continue to manufacture for thirty days after notice of cancellation, and under contract GA–126 it had the right to convert the contract into a cost plus contract. (See Special Finding 21, R. 67–69; copies of contracts P6489–1489Sa, article V; P12289–3034A, article XIV; GA–126, article VII; P12621–3124A, article XIV, R. 125, 141, 153, 170.)

The Chief of Ordnance did not exercise these options to cancel. Instead, he sent to the petitioner written requests (called "suspension requests") to suspend production under the respective contracts with a view to settlements by negotiation. Each suspension request contained substantially the following language:

> "This request is made with a view to negotiation of a supplemental contract providing for the cancellation, settlement and adjustment of your existing contract in a manner which will permit of a more prompt settlement and payment than will be practicable under the terms of said existing contract."

Copies of these requests are annexed to the petition filed

in the Court of Claims (exhibits E, F, G, H, R. 52–56). The petitioner received these requests in December, 1918, and complied with them and suspended production under all the contracts (Special Finding 22, R. 69).

On December 31, 1918, the petitioner had on hand material and work in process, constituting the inventories in question, which had been acquired and worked for the purpose of manufacturing the articles specified in these contracts, and which, because of such suspension requests, would not be required in making completed articles (Special Finding 23, R. 69). It was not possible for the petitioner to use such inventories advantageously by manufacturing them into the articles for which they had been intended, as there was no market for such articles. There was no way in which the petitioner could get back what the inventories had cost, except by settlements with the United States. The material in these inventories was not salable at any price approaching cost (Special Finding 24, R. 70).

The petitioner contended that this material and work in process should be valued as of December 31, 1918, at its market value, which was $231,615.43 (Special Findings 41–42, R. 76–77). In the year 1926, the Commissioner of Internal Revenue, in assessing additional taxes upon the petitioner for 1918, valued this material and work in process at $732,088.62. This amount was a composite figure, made up of three elements, (1) cost for such portions of the inventory as were taken over at cost by the United States as a result of various settlement contracts which were made in 1920–1922, (2) the amount received in such settlements for certain material which was paid for in these settlements at less than cost, and (3) the fair market value on December 31, 1918, for such material only as was not taken over in the settlements (Special Finding 41, R. 76). By valuing these inventories at $732,088.62, instead of their market value ($231,615.43), the Commissioner increased the apparent taxable income of the petitioner for 1918

by $500,473.19 and thereby increased the petitioner's taxes by 82.4% of this amount. (See p. 4 above.)

At the end of 1918 the prospects as to whether the petitioner would obtain settlements of its contracts were wholly uncertain. This appears from the history of the negotiations which led up to the settlements of 1920–1922. The details of this history are contained in Special Findings 25–40, R. 70–76. A condensed statement follows.

During the year 1918 no settlement was made of any of the contracts, and no negotiations took place other than the suspension requests. No policy was adopted by the War Department until March 6, 1919, which permitted a settlement for an inventory under a suspended contract where the parties could not agree upon the settlement of the contract as a whole. The petitioner had substantial claims under each contract for items other than inventories, which remained unsettled until the time of the final settlements of the respective contracts. Although partial settlements were made in 1920, the first final settlement was made in December, 1921 (Special Findings 25–27, R. 70).

In February, 1919, the Ordnance Department assigned a committee to the petitioner's plant for the purpose of settling its contracts. The petitioner negotiated with this committee and other Government agencies which subsequently took over its work, with the result that agreements were made in the year 1920 that the United States would take over and pay for most of the petitioner's inventories of raw material and work in process. In the year 1920 the United States took over the greater part of such materials and paid for them at cost, excepting the cost of labor and overhead on the material in process (Special Findings 28–33, R. 70–72). There were at the time many unsettled differences between the parties as to the amounts to be allowed for such labor and overhead. There were also certain inventory items which the United States would not at the time accept or pay for. In the final settle-

ments in 1921 and 1922, the United States agreed to pay for some of these items and declined, on various grounds, to reimburse the petitioner for any loss on others. In some instances a compromise was made by which the petitioner was reimbursed for a part of the cost of certain items, and received no reimbursement for the balance (Special Findings 33–34, R. 72).

The preparation and presentation of the petitioner's claims under its various war contracts in accordance with the requirements of the War Department, and the Government audit of those claims, required a large amount of work extending over several years. The petitioner had claims against the United States under war contracts other than those described above, including a cost plus contract (known as No. 14066) which was much larger than the contracts described above taken together. The petitioner at times employed as many as thirty-five or forty persons on its claims, and spent approximately $400,000, exclusive of legal expenses, in meeting the requirements of the War Department as to the proof of its claims under its various contracts including, among others, contract 14066 and the contracts involved in the present case (Special Finding 85, R. 73).

A number of obstacles in the way of the settlement of some or all of the petitioner's contracts appeared during the negotiations. One of these related to contract P6489–1489Sa, which was by far the most important contract involved. (See Special Finding 38, R. 75.) That contract had been modified by a supplemental agreement (printed at R. 132) by which the quantity of cartridges to be delivered had been increased and the specifications in the original contract had been somewhat changed. The original contract was a properly executed written agreement which complied with Revised Statutes, sec. 3744, but the supplemental agreement was not. The War Department treated the original contract, as amended, as one not executed in accordance with law. The difficulty with respect to payment for undelivered material which would

have resulted from this ruling was removed by the Dent Act (40 Stat. 1272) which was passed on March 2, 1919; and contract P6489–1489Sa and its supplement were settled under procedure established to cover contracts not executed in accordance with law (Special Finding 30, R. 71).

Other obstacles which threatened the success of the negotiations for settlement of the petitioner's contracts are stated in detail in the findings of the Court below (Special Findings 33–34, 36–37, R. 72–74). These included the probability that the War Department agencies which were dealing with the petitioner's claims would be dissolved before these claims could be presented; and the probability that no appropriations which could be used for payment of claims under suspended contracts would be available long enough to permit the payment of the petitioner's claims, with the exception of a claim for cost of unworked materials under contract P6489–1489Sa, which was settled and paid for in January, 1920, at a time when appropriations were expected to be available (Special Findings 32, 36–37, R. 71–74). As it turned out, the agencies of the War Department for the settlement of claims under suspended contracts were continued, and Congress renewed the appropriations for payment of such claims, so that the War Department was able to make the final settlements and to pay the petitioner for its inventories in accordance with them.

After the final settlement contracts were made in 1921 and 1922, the United States still withheld $52,591.05 of the amount agreed to be paid under two of these contracts, and applied it to an alleged overpayment for finished goods under one of the contracts. In 1926, the petitioner recovered this amount as the result of a suit in the Court of Claims (Special Finding 39, R. 75).

The Court of Claims sustained the Commissioner in valuing the inventories in question on December 31, 1918 at $732,088.62 instead of at their market value ($231,615.43).

IV.

SPECIFICATION OF ERRORS.

The petitioner contends that the Court below erred in the following respects:

1. The Court below erred in not allowing the petitioner a deduction of $327,937.35 from its gross income for 1918 on account of the cost of buildings erected by the petitioner on leased land, in addition to the deduction of $86,484.54 which was allowed by the Commissioner of Internal Revenue.

2. The Court below erred in denying to the petitioner a deduction from its gross income for the year 1918 on account of the cost of buildings erected by it on leased land in addition to the deduction of $86,484.54 allowed by the Commissioner of Internal Revenue.

3. The Court below erred in failing to rule that in determining the petitioner's income for the year 1918, the inventories of the petitioner on hand at the end of that year, which the petitioner had acquired for use under its contracts with the United States which had been suspended, should be valued at their market value on December 31, 1918.

The foregoing are the fundamental errors claimed by the petitioner which are intended to include the following subsidiary errors which are assigned:

4. The Court below was in error in holding and ruling that the use which was made by the petitioner of its buildings after 1918 was a bar to a deduction for obsolescence in addition to the deduction of $86,484.54 allowed by the Commissioner of Internal Revenue.

5. The Court below was in error in holding and ruling that under the terms of the cancellation clauses in the petitioner's contracts with the United States, the petitioner became entitled during the year 1918 to be paid for its inventories at cost.

6. The Court below was in error in holding and ruling that the inventories of the petitioner intended for use under its contracts with the United States should be valued as of the end of the year 1918 according to the amounts received for them in settlements made in later years.

7. The Court below was in error in holding and ruling that the decision of the Board of Tax Appeals in *Producers Fuel Co.*, 1 B. T. A. 202 was applicable to the case at bar.

V.

SUMMARY OF ARGUMENT.

A. The deduction on account of the cost of buildings erected for war purposes on leased land should be allowed.

The question between the parties is whether, as claimed by the petitioner, enough of the cost of these buildings should be charged off by the end of the war years to bring their book value down to what they were worth for peace-time purposes during the remainder of the lease; or whether, as claimed by the Commissioner, the cost of these buildings should be charged off solely on a time basis, so as to allocate an equal amount to each of the years of the lease. The petitioner maintains that, as these buildings were built solely for war production, the first method is the reasonable one. As bearing on this question the petitioner submits:

1. The decision in the case of *Burnet* v. *Niagara Falls Brewing Co.*, 282 U. S. 648, supports the deduction which is claimed by the petitioner.

2. The fact that the petitioner's buildings became obsolete for the purpose for which they were built within a single tax year is not a bar to the deduction claimed.

3. The allowances made by the Commissioner in the years 1919–1924 on account of the cost of the buildings are not a bar to relief.

B. The petitioner's inventories acquired for use under its contracts with the United States should have been valued on December 31, 1918, at their market value, $231,615.43.

1. On December 31, 1918, it was wholly uncertain what would become of these inventories and the petitioner had no contracts under which it was entitled to deliver these inventories and to be paid for them.

a. On December 31, 1918, the inventories did not include anything which was to be used to make such completed articles as were called for by the contracts.

b. On December 31, 1918, the petitioner had no contracts with the United States by which the United States agreed to accept these inventories and to pay for them at cost.

c. On December 31, 1918, it was wholly uncertain whether the petitioner would reach any settlements of its contracts and whether, if it did, the settlements would involve the taking over of the inventories and payment for them at cost.

d. Up to the time of the partial settlements made in 1920 the petitioner had no agreement that its inventories would be taken over and paid for at cost, and up to the time of the final settlements made in 1921–1922, the amount which the petitioner was to be paid was unliquidated.

2. Under the circumstances which existed the inventories should have been valued at their market value on December 31, 1918, ($231,615.43) and not at the amount ($732,088.62) which was realized for them in later years through the settlement agreements.

a. The income which Congress intended to tax by the Revenue Act of 1918 was income which was so realized as to be available to the taxpayer according to ordinary business usage and the petitioner's inventories were so available only at their market value.

b. The system of taxation contained in the Revenue Act of 1918 is based on an annual accounting period; and the petitioner's inventories should therefore be taken at their value at the end of 1918.

c. According to good accounting practice, which is recognized by the Revenue Act of 1918 and by the regulations as a standard, these inventories should be valued at their market value.

d. The regulations which relate to the valuation of inventories and to the proceeds of the settlement of claims on Government contracts require that these inventories be valued at their market value.

e. The argument that valuing the inventories at market permits the petitioner to take a loss before it is sustained is not valid.

C. The statutes and regulations should be liberally construed in favor of the taxpayer.

VI.

ARGUMENT.

The two questions involved require separate treatment. The points relating to the deduction claimed on account of the cost of buildings erected on leased land will be stated first, and then those relating to the value of inventories under the United States contracts.

A. In determining the petitioner's taxes for the year 1918, the deduction of $327,937.35 claimed by the petitioner on account of the cost of buildings erected for war purposes on leased land should have been allowed.

The statute involved is section 234(a) of the Revenue Act of 1918 the material portion of which reads as follows:

"Sec. 234 (a) That in computing the net income of a corporation subject to the tax imposed by section 230 there shall be allowed as deductions . . .

(4) Losses sustained during the taxable year and not compensated for by insurance or otherwise; . . .

(7) A reasonable allowance for the exhaustion, wear and tear of property used in the trade or business, including a reasonable allowance for obsolescence;"

Copies of the regulations referred to by the parties are printed in the appendix to this brief. They include Regulations 45, articles 143, 161, 162 and 165. Article 109 of these regulations, on which the respondent relied in the Court below, is also printed in the appendix.

In this case it is conceded that the petitioner has a right to charge off the entire cost of these buildings by the end of the ten year period of the lease. The only controversy between the parties is as to the method by which this shall be done. The Commissioner maintains that it must be done mathematically, so as to charge off each year the same proportional part of the cost of each building. The petitioner maintains that as these buildings were constructed for its war business and the petitioner had no use for them for its ordinary business, the greater part of the cost ought to be charged against the war period, and that against the period which came after the war only that portion of the cost should be charged which represents the fair value of the right to use them for that period.

The most significant facts which have a bearing upon these claims are the following:

The petitioner constructed the buildings in question solely for war uses. It had no use for them for its normal peace-time business and had not been making any money in that business (Special Findings 43, 46, R. 77–78).

It constructed these buildings on leased land under an agreement that they should revert to the landlord at the end of the lease on December 31, 1924. Their usefulness to the petitioner was therefore bound to end by that definite date at the latest (Special Finding 44, R. 77).

These new buildings were all used by the petitioner up to the time of the Armistice and the petitioner had orders up to that time to its capacity and had no way of knowing when the demand for ammunition for war purposes would stop (Special Finding 47, R. 79). For that reason the petitioner was unable, up to the year 1918, to charge off in any year more than a proportionate part of the cost based on charging off the total cost by December 31, 1924.

After the Armistice and as a result of it, the petitioner's officers had no expectation of continuing the manufacture of ammunition for war purposes for which the buildings had been built, and received no new orders for military ammunition and did not expect any (Special Finding 47, R. 79).

No income could be derived by renting the new buildings as there was no demand for buildings of this character (Special Finding 51, R. 81).

The new buildings had been so incorporated into the buildings rented by the petitioner from its landlord that the two had to be used as a unit unless the plant was revamped, and this was not considered or done (Special Finding 51, R. 81).

In an effort to get some return out of the buildings during the last six years of the lease (1919–1924) the petitioner used them in its commercial (peace-time) ammunition business and for certain other new businesses which it attempted to carry on. None of these businesses proved profitable and the petitioner obtained no net return from these attempts to use the buildings (Special Finding 51, R. 81).

The depreciated cost of the buildings at the beginning of 1918 was $605,391.75. At the end of 1918 the actual value of the right to use the buildings for the remainder of the lease did not exceed $190,969.86 (Special Findings 49, 53, R. 79, 82).

Under these circumstances the petitioner charged off on its books for the year 1918 the difference between the depreciated cost, $605,391.75, and the residual value of its property, $190,969.86, or $414,421.89, and claimed a deduction of this amount

in its income tax returns. The Commissioner of Internal Revenue ruled that the petitioner was not entitled to this allowance because it had not abandoned the buildings or permanently devoted them to a radically different use. He therefore allowed only $86,484.54 for depreciation of the buildings for 1918. This allowance was based on charging off an equal amount each year throughout the lease and took no account whatever of the change in conditions which resulted from the Armistice (Special Finding 49, R. 79–80). The result of the Commissioner's method is to allocate to the war years (1915–1918) $283,592.28, or 35% of the cost of the buildings, and to the later years $518,907.21 or 65% of this cost. The method used by the petitioner allocates $611,529.63, or about 76% of the cost to the war years and $190,969.86, or about 24% to the later years. In view of the facts that these buildings were built solely for war production and the petitioner at the time had no other use for them (Finding 46, R. 78) it is apparent that the latter method is more reasonable. An accurate accountant or business man would certainly charge off enough of the cost of such buildings at the end of 1918 so that they would be carried on the books for no more than their real value for peace-time purposes. The Court of Claims specifically found that the value of the right to use the buildings for the remainder of the lease after December 31, 1918, did not exceed $190,969.86 (Special Finding 53, R. 82). Nevertheless, the Court sustained the Commissioner in allocating deductions to various years on a purely proportionate basis. The reasons assigned by the Court are discussed in connection with the points stated below.

1. The decision in the case of Burnet v. Niagara Falls Brewing Co., 282 U. S. 648, supports the deduction which is claimed by the petitioner.

In *Burnet* v. *Niagara Falls Brewing Co.*, it was held that a corporation engaged in making beer was entitled to an allow-

ance for obsolescence of its brewery buildings arising from national prohibition, although the company continued to use them in making soft drinks after prohibition went into effect. This case is similar in all essential respects to the case at bar.

In the *Niagara Falls Brewing Company* case, the buildings had been acquired or constructed for the purpose of making beer. The company could find no use for the property after national prohibition went into effect, except for the purpose of making near beer and other soft drinks. The company began the manufacture of near beer in 1917 and manufactured substantial quantities of near beer in the plant until 1921. In 1921 the company sold some of its land and its remaining property was leased at a small rental. Finding that it could not make any profit in near beer and soft drinks, the company ceased business in December, 1921. It was contended by the government that the use of the plant for making near beer after national prohibition went into effect in January, 1920, prevented any allowance for obsolescence. The Court held that the use which was made of the property after prohibition went into effect was not a bar to such an allowance, and that the sums received on the sale and as rents constituted mere salvage to be taken into account in determining the amount of obsolescence.

This case is similar in all essential respects to the case at bar. In both cases the buildings were acquired for a particular purpose, for which they could no longer be used. In the *Niagara Falls Brewing Company* case the cause of the change was statutory prohibition. In the case at bar the cause was the complete stopping of the demand for war ammunition which resulted from the Armistice. The opinion of the Court of Claims attempts to distinguish the *Niagara Falls Brewing Co.* case on the ground that that case was one where use of the buildings for the purposes intended was prohibited by law and the buildings were "not readily adaptable to other uses" (R. 108–109). It is submitted that this distinction is not sound. The opinion

in the *Niagara Falls Brewing Co.* case clearly treats loss of trade as one of the changes which may result in obsolescence and also shows that the buildings in that case were adaptable to making soft drinks. (See opinion in *Burnet* v. *Niagara Falls Brewing Co.* 282 U. S. 648 at pages 652, 654.)

Another reason advanced by the Court of Claims is that the allowance of annual depreciation made by the Commissioner would eventually return the cost of the buildings and therefore no other allowance for obsolescence was necessary (R. 106, 109). This reasoning fails to distinguish between the ordinary allowance made on a time basis (ordinary depreciation and exhaustion) and obsolescence, which is a more rapid loss of value caused by change of circumstances. A taxpayer who constructs a building is always entitled to a deduction for ordinary depreciation. Similarly a tenant who erects buildings on leased land which will become the property of the landlord at the end of the lease is always entitled to proportionate annual allowances for exhaustion.

> *Duffy* v. *Central R. R. Co. of New Jersey*, 268 U. S. 55, cf. Art. 109, Regulations 45, printed at page 104 of record.

Burnet v. *Niagara Falls Brewing Co.* is a clear authority for the allowance of obsolescence in excess of ordinary depreciation in the year in which the buildings ceased, because of changes in trade, to be useful for the purposes for which they were built or acquired. It was undoubtedly true in that case that if no obsolescence had been allowed, the taxpayer might in course of time have obtained allowances equivalent to the cost of its buildings through losses incurred on sales or through ordinary depreciation. This did not prevent the allowance of obsolescence at the time when it occurred. Similarly in the case at bar, the fact that the annual allowance made by the Commissioner would eventually return the cost of the buildings should not prevent a reasonable allowance for 1918

on account of the complete change in trade caused by the end of the war.

Another reason relied on by the Court of Claims is that obsolescence should not be allowed when buildings are continued in use by their owner (Opinion, R. 105–109). It is submitted that this reasoning is entirely inconsistent with the decision in the *Niagara Falls Brewing Co.* case. In reply to the contention that obsolescence begins only when there is a reasonable certainty that the property cannot be used by the owner *for any purpose*, the opinion in the *Niagara Falls Brewing Co.* case states, "There is no hard and fast rule, as suggested by the Government, that a taxpayer must show that his property will be scrapped or cease to be used or useful for any purpose, before any allowance may be made for obsolescence . . . The company was unable to find any profitable use to which the property could be put. The sums received on the sale and as rents constituted mere salvage." (See Opinion, 282 U. S. 648, at pp. 655, 656.)

It is to be noted that there is nothing in the language of the statute which makes total abandonment of the property a condition of an allowance for obsolescence.

The Commissioner of Internal Revenue cannot by regulations or otherwise lawfully impose a condition as to abandonment which is not found in the statute.

United States v. *George*, 228 U. S. 14.
International Railway Co. v. *Davidson*, 257 U. S. 506.
Campbell v. *Galeno Chemical Co.*, 281 U. S. 599, 610.

The Court of Claims also relied on a number of decisions of the Board of Tax Appeals (R. 106–108). The objection to the use of these decisions as authorities is that they represent a line of cases inconsistent with the decision of this Court in the *Niagara Falls Brewing Co.* case. It should be noted that the *Niagara Falls Brewing Co.* case originated in the Board of Tax Appeals, and was there decided adversely to the taxpayer

on the ground that no allowance for obsolescence on brewery property could be made where it was continued in use by the taxpayer after prohibition. (See *Niagara Falls Brewing Co.* 13 B.T.A. 1040 at 1049.) Prior decisions of the Board of Tax Appeals based on a similar rule were

Yough Brewing Co., 4 B.T.A. 612.
Star Brewing Co. Inc., 7 B.T.A. 377.
Tennessee Fibre Co., 15 B.T.A. 133.
Marigold Garden Co., 6 B.T.A. 368.
McCabe Lathe & Machinery Co., 9 B.T.A. 1137.

It would seem that until the Board of Tax Appeals has rendered a decision with respect to obsolescence which takes into account the decision of this Court in the *Niagara Falls Brewing Co.* case, citations from opinions of the Board of Tax Appeals on the issue now presented cannot be of assistance.

2. The fact that the petitioner's buildings became obsolete for the purpose for which they were built within a single tax year is not a bar to the deduction claimed.

A suggestion is found in a quotation contained in the opinion of the Court of Claims that obsolescence is intended to care for losses of capital which take place over a longer period than a taxable year. (See quotation from *Tennessee Fibre Co.*, 15 B. T. A. 133, R. 106.)

While it is true that obsolescence may take care of losses extending over more than one tax year, there is nothing in this quotation or in the statute to warrant the inference that obsolescence is confined exclusively to such losses, or that a taxpayer cannot have any allowance for obsolescence which begins and ripens into obsoleteness within a single year.

It is not conceivable that Congress meant to give a deduction to a taxpayer who sustained a loss which occurred partly in one year and partly in another, and to deny such a deduction to another taxpayer who had a similar loss which all happened

within one year. There was undoubtedly a period of several weeks before the Armistice in which it was apparent that the end of the war was near. It happened that this period fell entirely within the months of September, October and November, 1918. It might well have happened that the period would have included December, 1918, and January, 1919. There is no reason for applying different rules in the two cases. Obsolescence which ripens into obsoleteness within a single tax year is as clearly within the language of section 234 (a) (4) and (7) as is similar obsolescence which begins in one year and ripens into obsoleteness in the succeeding one.

In the case at bar it is clear that up to the year 1918 no one could foretell how long the war would last or how long the plaintiff's buildings could be used in making war munitions. The Commissioner of Internal Revenue properly refused to permit the petitioner to deduct more than a proportionate part of the cost of its war plant in years preceding 1918 (Special Finding 48, R. 79).

It is to be noted that the new buildings were all used by the petitioner up to the time of the Armistice and the petitioner had orders up to that time to its capacity. With the Armistice the petitioner's war business came to an end. The petitioner's officers then had no expectation of continuing the manufacture of ammunition for war purposes and received no new orders for military ammunition and did not expect any (Special Finding 47, R. 79).

3. The allowances made by the Commissioner of Internal Revenue in the years 1919–1924 on account of the cost of the buildings are not a bar to relief.

In the Court below it was argued for the respondent that if the petitioner should now obtain the allowances claimed for 1918 there would be a double deduction, as the Commissioner allowed for the years 1919–1924 deductions aggregating the amount which he disallowed for 1918. This argument ignores

the findings that the allowances for later years were not claimed by the petitioner but were made by the Commissioner on his own motion as a result of his disallowance of the claim made for the year 1918; and that when he made this disallowance for 1918, the taxes for all the later years were still open, as the petitioner had waived the statute of limitations (Special Finding 49, R. 80–81). The state of affairs which now exists was one which the Commissioner deliberately created with all the facts before him. He allowed these deductions in years when the rates of tax were so low that they made very little difference to the petitioner, and disallowed an equivalent deduction in 1918 when the taxes involved amounted to 82.4% of the deduction. The Commissioner could not, by forcing upon the petitioner deductions in later years which were not asked for, deprive the petitioner of a deduction to which it was entitled in 1918. Furthermore, the petitioner has no intention of obtaining a double deduction. Counsel was authorized to state, and did state in writing in the Court below, that if the deduction claimed for 1918 was finally established and a corresponding refund of taxes obtained, the petitioner would pay or cause to be paid such added amounts of tax, if any, as might be due for later years (either under the petitioner's returns or under consolidated returns which included the petitioner's income) because of any restatement of such deductions for later years which might be necessary in order to avoid duplication of the same allowance. Under this offer it is to be understood that in case taxes for later years have been finally settled, those years are to be opened up only as to items which the final judgment in this suit would result in changing and only to the extent that changes in such items are required as a result of such judgment.

B. The petitioner's inventories acquired for use under its contracts with the United States should have been valued on December 31, 1918, at their market value, $231,615.43.

The Commissioner, in determining the petitioner's taxes for 1918, valued these inventories at $732,088.62, which was the amount realized. This was a composite figure made up of the amount realized for these inventories in later years through the settlement agreements together with the market value of that portion of the inventories which the Government eventually declined to take over in the final settlements (Special Finding 41, R. 76). There is no dispute as to the market value of this inventory on December 31, 1918. The Court of Claims has found that it was $231,615.43 (Special Finding 42, R. 77). The issue between the parties is whether this inventory should be valued on December 31, 1918, at its market value at the time, or at the amount which was eventually obtained in consequence of the settlements made several years later. The effect of using the larger valuation adopted by the Commissioner is to increase the taxable income of the petitioner in the year 1918 by the difference between the two figures, or $500,473.19, and to increase the taxes for 1918 by 82.4% of that amount. (See page 4 above.)

The statute involved is section 203 of the Revenue Act of 1918 which reads as follows:

> "That whenever in the opinion of the Commissioner the use of inventories is necessary in order clearly to determine the income of any taxpayer, inventories shall be taken by such taxpayer upon such basis as the Commissioner, with the approval of the Secretary, may prescribe as conforming as nearly as may be to the best accounting practice in the trade or business and as most clearly reflecting the income."

The material regulations are Regulations 45, articles 22–24 and

1582–1584 (as amended by Treasury Decision 3296); and Regulations 65, articles 1612–1614 (identical with said articles 1582–1584) and article 50. The material portions of these regulations are printed below at pp. 42–44.

The facts concerning the question now presented are summarized in this brief at pages 8–13. As is shown below, it is clear from these facts that on December 31, 1918, it was wholly uncertain what would become of the inventories in question; and also that on that date the petitioner had no contracts under which it was entitled to deliver these inventories and to be paid for them. It also appears that up to the time of the partial settlements made in 1920 the petitioner had no agreement that its inventories would be taken over and paid for at cost and that up to the time of the final settlements made in 1921–1922 the amount that the petitioner was to be paid was unliquidated.

1. On December 31, 1918, it was wholly uncertain what would become of these inventories and the petitioner had no contracts under which it was entitled to deliver these inventories and to be paid for them.

a. On December 31, 1918, these inventories did not include anything which was to be used to make such completed articles as were called for by the contracts.

The articles to be delivered under the contracts were cartridges and artillery primers. The inventories in question included only raw materials and work in process which were not needed in order to complete the limited number of finished articles which the suspension requests permitted the petitioner to furnish. (Special Findings 23–24, R. 69–70.)

b. On December 31, 1918, the petitioner had no contracts with the United States by which the United States agreed to accept these inventories and to pay for them at cost.

The opinion of the Court of Claims was apparently written in a belief to the contrary. The Court below states:

> "The United States contracts clearly disclose 'firm sales contracts at fixed prices' and while the contracts were subject to cancellation, they contained express covenants upon the part of the United States to save the plaintiff harmless in so far as the cost of materials, etc., entering into its inventory is concerned. The contracts contained express provisions setting forth with exactness how the plaintiff should be paid, and the items included within the Government's liability to pay." (R. 97–98.)

In reaching this conclusion the Court of Claims has overlooked the terms of the original contracts and of the suspension requests and the decision of this Court in *College Point Boat Corporation* v. *United States*, 267 U. S. 12. The contracts are listed on page 6 of the printed record. Copies are printed in the record beginning at pages 120, 132, 134, 146 and 163. The respective cancellation clauses of the contracts are printed at pages 125 (Art. V), 134 (Art. IV), 141 (Art. XIV), 153 (Art. VII) and 170 (Art. XIV). The suspension requests are printed as exhibits E, F, G and H at pages 52–56.

An examination of the cancellation clauses and of the suspension requests shows clearly that the Chief of Ordnance by the suspension requests was not exercising rights given by the cancellation clauses. A typical cancellation clause is Article XIV of contract P12289–3034A, beginning on page 141 of the record. This clause recites that it is desirable that provision be made for the cancellation of the contract in the event of the termination or limitation of the war or in anticipation thereof and provides that at any time the Chief of Ordnance may for any of the causes stated notify the contractor that any part of the articles remaining then undelivered shall not be manufactured or delivered. The clause further provides that in the event of such complete or partial termination the United

States shall accept all completed articles then on hand and such as may be completed within thirty days after such notice and pay the contract price therefor; and that the United States shall also pay to the contractor the cost of the materials and component parts purchased by the contractor for the performance of the contract and then on hand, and all costs incurred by the contractor in the performance of the contract remaining unpaid, together with such added sums as the Chief of Ordnance may deem necessary to compensate the contractor. The suspension notice under this contract is printed at page 54 of the record. It contains no recital that any of the causes specified in the contract exist. It makes no provision for continuing operations for thirty days as provided in the termination clauses of the contract, but on the contrary requests the petitioner to suspend further operations immediately.

The second paragraph of the suspension notice states, "This request is made with a view to the negotiation of a supplemental contract providing for the cancellation, settlement and adjustment of your existing contract, in a manner which will permit of a more prompt settlement and payment than will be practicable under the terms of said existing contract." This paragraph makes it clear that the suspension request is made not as a termination under the existing contract, which would give the contractor specific rights set out in the cancellation clause, but with a view "to the negotiation of a *supplemental contract* providing for the cancellation, settlement and adjustment" of the existing contract in a manner different from that specified in the contract. The paragraph speaks of a "more prompt settlement and payment than will be practicable under the terms of said existing contract."

The third paragraph of this suspension notice requests the petitioner to acknowledge receipt of the notice immediately "and indicate your decision as to compliance with or rejection of this request." This paragraph also clearly shows that the

Chief of Ordnance was not exercising the option to cancel contained in the original contract. If he had been doing this, it would not be necessary for the petitioner to indicate "its compliance with or rejection of this request." The petitioner would have had no option as to whether it would or would not accept the cancellation notice under the contract. The Chief of Ordnance clearly was not intending to give such a notice.

One reason why the Chief of Ordnance did not give the termination notice called for by the contract was undoubtedly that the War Department found itself at the end of the war with more munitions on hand than it needed. If the War Department had exercised the options contained in the cancellation clauses of its various contracts, the United States would have had to pay for thirty days production of goods of which it already had a surplus. Accordingly, the Chief of Ordnance preferred to stop production more quickly than he could have done under the termination clauses and adopted the suspension requests as a means of so doing.

The petitioner complied with the suspension requests (Special Finding 22, R. 69). The situation in the case at bar was then precisely that which existed in *College Point Boat Corporation* v. *United States*, 267 U. S. 12. In that case the Navy Department, which had a statutory right to cancel a contract, failed to give the notice requisite to cancel the contract. The Department did, however, request the contractor to stop operations and asked it to submit a proposition for cancellation of the contract. As was observed in the opinion (at page 15), "Its sole objective in suggesting that preparations for the performance of the contract be stopped was to avoid useless production. The Corporation necessarily acquiesced. The parties negotiated, seeking to find a basis on which they could agree to cancel and liquidate the obligation of the Government. In the negotiations, and in the agreements which embodied the partial settlement, the Navy used language inconsistent with an intention to exercise a right of cancellation."

Another decision which upholds the rule that cancellation clauses must be strictly complied with is *Valente* v. *Weinberg*, 80 Conn. 134. To the same effect see *Burton Coal Company* v. *United States*, 60 C. Cls. 294.

As the original contract in the case at bar contained no provisions for the delivery of unfinished articles, except the cancellation clauses, and as the options to cancel were not exercised, it is impossible to support the conclusion of the Court of Claims that the original contracts provided "with exactness how the plaintiff should be paid, and the items included within the Government's liability to pay."

The situation which existed on December 31, 1918 was that the plaintiff had suspended production under its existing contracts at the request of the Chief of Ordnance; that it knew that the United States did not intend to permit any further deliveries of completed articles except as specified in the suspension requests; that, as the Chief of Ordnance had not exercised the options to terminate under the contracts, the petitioner had no right to tender delivery of the raw materials on hand and to be paid for them at cost; and that the petitioner's chances for reimbursement for its damages by reason of the stopping of the deliveries by the Chief of Ordnance lay either in successful negotiations or suits for damages for breach of contract.

The settlement contracts themselves furnish further proof that the parties did not treat the suspension notices as exercises of the options given by the cancellation clauses. Supplemental agreements made in 1920, which provided for payment for the inventories under Contracts P12289–3034A and GA–126, were introduced in evidence and are printed in the record at pages 174–184. (See Special Finding 31, R. 71.) The supplemental agreement made under contract P12621–3124A was similar in form (Stipulation, R. 201). The fact that the War Department entered into these supplemental contracts is inconsistent with the contention that the inventories were delivered and

paid for under the cancellation clauses contained in the original contracts; for if the parties were proceeding under the cancellation clauses, the inventories would have been delivered and vouchered and paid for according to the terms of the original contracts and there would have been no occasion for any supplemental contracts. Furthermore, the language of these supplemental contracts shows that the parties considered that they were executing a partial rescission of the original contracts rather than carrying out their terms.

The settlement of the largest contract, P6489–1489Sa, was made by the War Department under the Dent Act, which was not passed until March 2, 1919. This method of handling the settlement is entirely inconsistent with any belief on the part of the Chief of Ordnance that he had exercised the option to cancel contained in the contract and that the settlement was merely the performance of the cancellation clause (Special Finding 30, R. 71).

c. On December 31, 1918, it was wholly uncertain whether the petitioner would reach any settlements of its contracts and whether, if it did, the settlements would involve the taking over of the inventories and payment for them at cost.

It is expressly found that on December 31, 1918, there was no way in which the petitioner could get cost for the inventories in question except by settlements with the United States. The materials were not salable at cost or at anything approaching cost (Special Finding 24, R. 70).

The suspension requests plainly contemplated negotiations looking toward some form of compensation to the petitioner on account of the stopping of further deliveries. At the end of the year 1918 no one could know what form any settlements would take with respect to inventories, or whether the parties to a given contract would agree on a settlement.

Nothing happened in 1918 which gave the petitioner any assurance that the settlements, if made, would include the

acceptance of the inventories by the Government and payment for them at cost. It was clear that the War Department did not want any more ammunition. There was nothing at the time to indicate that the War Department would adopt the policy which was later followed of taking over the enormous quantities of materials for ammunition which the various contractors had on hand, and setting up elaborate machinery for disposing of these materials, rather than leaving the materials in the hands of the contractors and making negotiated settlements with them as to their losses.

It is also to be noted that it was not until after 1918 that the War Department adopted a policy which permitted a partial settlement for an inventory where the parties had not reached a complete settlement of a contract.

The date when the War Department adopted the policy of partial settlements for inventories was March 6, 1919 (Special Finding 26, R. 70). As the petitioner had important claims under each of the contracts in addition to those relating to its inventories, and as, at the end of 1918, it was wholly uncertain whether the parties would ever agree as to the settlement of any of these other claims, the prospects at that time for a settlement of its inventory claims were equally uncertain.

In the event that the petitioner could not agree with the War Department as to the terms of the settlement of any contract, its remedy, if any, would be only by suit in the Court of Claims for breach of contract. The Comptroller of the Treasury and the Comptroller General could not settle such complicated, unliquidated claims for breach of contract.

Power v. *United States*, 18 C. Cls. 263.

In any such suit it is clear that the judgment would not be that the United States should take the inventories and pay cost for them, but the petitioner would keep the inventories and, if it prevailed, would obtain a judgment for a sum of money to cover the petitioner's loss because the United States had failed

to accept and to pay for the completed articles specified in the contracts.

United States v. *Behan*, 110 U. S. 338.
United States v. *United States Fidelity & Guaranty Co.*, 236 U. S. 512, 525.
Guerini Stone Co. v. *Carlin Construction Co.*, 248 U. S. 334, 343.

Furthermore there was doubt at the time and for several years afterwards as to whether a contractor could treat a suspension request as a breach of contract where it had assented to the request. The earlier decisions of the Court of Claims increased this doubt.

Dorris Motor Car Co. v. *United States*, 60 C. Cls. 68, 78.
Savage Arms Corporation v. *United States*, 57 C. Cls. 71, 85–86.

It was only after the decision of this Court in *College Point Boat Corporation* v. *United States*, 267 U. S. 12, which was handed down in January, 1925, that there was clear authority for treating such a request as a breach of contract in case negotiations failed.

d. Up to the time of the partial settlements made in 1920 the petitioner had no agreement that its inventories would be taken over and paid for at cost; and up to the time of the final settlements made in 1921–1922, the amount which the petitioner was to be paid was unliquidated.

The first proposition in this conclusion follows from the points which have already been stated and the last from the facts relating to the negotiations for settlement which are summarized above at pages 11–13. These facts show that on more than one occasion it appeared that any settlement of the petitioner's claims through the War Department was improbable, and that up to the time of the final settlements the amount of the claims was unliquidated.

2. Under the circumstances which have been stated the inventories should have been valued at their market value on December 31, 1918 ($231,615.43), and not at the amount ($732,088.62) which was realized for them in later years through the settlement agreements.

It is apparent from what has already been stated that what the petitioner had on December 31, 1918 was (1) inventories worth as merchandise $231,615.43, and in addition (2) claims for a much larger amount for reimbursement for the difference between the cost of its inventories and what they were worth as merchandise. The petitioner's chances for such reimbursement depended either on negotiations or on the outcome of a suit in the Court of Claims. As has been shown above, there was, on December 31, 1918, no ground for assurance as to the result of either negotiations or law suits. The petitioner contends that the Commissioner of Internal Revenue was not justified in valuing this merchandise as of December 31, 1918 at a figure which included its then present value plus the additional amounts eventually realized through the negotiations for the cancellation of the contracts.

a. The income which Congress intended to tax by the Revenue Act of 1918 was income which was so realized as to be available to the taxpayer according to ordinary business usage, and the petitioner's inventories were so available only at their market value.

The Revenue Act of 1918 imposed taxes running up to 82.4% of net income, which were payable during the year 1919. The inference is plain that Congress expected that taxpayers would have the income on hand out of which the taxes might be paid. It follows that the income intended to be taxed was something which, according to ordinary business practice, could be used to raise money with which to pay the taxes. Otherwise the result of the tax would in many cases

be bankruptcy. The inventories in question were available at their market value for this purpose, as a basis for credit or by sale. They were not available at a price which included the additional amounts realized by the settlements which were made in later years. It is clear that no one would purchase these inventories at more than their market value and it is equally clear that no one would lend on them an amount greater than their market value.

It is no answer to this argument that in the case at bar the petitioner succeeded in settling its contracts before it paid all of the taxes which were assessed by the Commissioner. The statute lays down a rule intended to be uniform, requiring payment of the taxes during the year 1919. It was only an accident in this case that the Treasury Department did not complete the audit of the petitioner's returns and the determination of its taxes until 1926. If the inventories should have been valued at $732,088.62 on December 31, 1918, the petitioner would have had no remedy if the examination had been completed and the additional taxes assessed in 1919.

b. The system of taxation contained in the Revenue Act of 1918 is based on an annual accounting period; and the petitioner's inventories should therefore be taken at their value at the end of 1918.

The decision of the Court of Claims was apparently based on the theory that the amount of the petitioner's taxes for 1918 might properly be kept open during the period of the statute of limitations and settled in the light of what the assets brought in later years within that period (see Opinion, R. 99–100). In support of this theory the Court relied on *Producers Fuel Co.*, 1 B.T.A. 202.

The objections to this treatment of the case at bar are that the Court below overlooked the general rule that taxes must be determined according to what takes place in the tax year, and also overlooked the fact that the *Producers Fuel Co.* case

is only a narrowly limited exception to this rule, and does not apply to the facts in the present case.

The general rule is stated as follows in a recent opinion of this Court:

> "The Federal income tax system is based upon an annual accounting period. This requires that gains or losses be accounted for in the year in which they are realized."
>
> *Lucas* v. *Kansas City Structural Steel Co.*, 281 U. S. 264, 268.

A later decision to the same effect is *Burnet* v. *Sanford & Brooks Co.*, 282 U. S. 359.

Producers Fuel Co., 1 B.T.A. 202, was a case in which a purchaser repudiated a contract to buy goods in December, 1920, and in the same month admitted liability for the breach, began negotiations for settlement, and set up a reserve for the amount of the damages. Settlements were made in January, 1921, by which the amounts to be paid were somewhat less than the reserve. The Board of Tax Appeals held that the purchaser might deduct a loss in 1920 but must substitute the amounts actually agreed on in settlement for the amount of the reserve. The decision has been limited to its special facts by later cases in the Board of Tax Appeals which the Court below did not notice. The limited scope of the decision is recognized in *Lucas* v. *American Code Co.*, Inc., 280 U.S. 445 at pp. 449–450, as follows:

> "The Board of Tax Appeals has held, in a series of well-reasoned opinions, that a loss occasioned by the taxpayer's breach of contract is not deductible in the year of the breach, except under the special circumstances where, within the tax year, there is a definite admission of liability, negotiations for settlement are begun, and a reasonable estimate of the amount of the loss is accrued on the books."

The cases in the Board of Tax Appeals are collected in a footnote to the same opinion at page 450. It is clear that the *Producers Fuel Co.* case does not support the doctrine that an inventory may be valued at the end of a given year according to what is obtained for it in later years.

The Treasury Department and the Board of Tax Appeals have consistently ruled that a taxpayer in valuing his inventories on the "cost or market" basis must take the market value at the end of the year, if there is one, rather than the prices prevailing even a very short time later (A. R. R. 6016, III–1 C. B. 59. *Crown Manufacturing Co.* v. *Commissioner*, 12 B.T.A. 37).

In A. R. R. 6016 the Committee on Appeals and Review said, "The profits of a year are determined by the conditions existing at the close of that year. To take an inventory at the close of a fiscal period and to hold that inventory in suspense and price it under conditions existing 90 days after the taking of that inventory certainly would not reflect a true statement of the operations for the period closed, nor can such be considered good accounting practice." (III–1 C.B. 59, 61.)

In *Crown Manufacturing Co.* v. *Commissioner*, 12 B.T.A. 37, the Board of Tax Appeals held that in pricing an inventory at the end of 1920 a valuation based on a sale on February 7, 1921, did not show the market value at the end of the year where the market was fluctuating.

c. According to good accounting practice, which is recognized by the Revenue Act of 1918 and by the regulations as a standard, these inventories should be valued at their market value.

The material portion of the Revenue Act of 1918 is section 203 which reads as follows:

> "That whenever in the opinion of the Commissioner the use of inventories is necessary in order clearly to determine the income of any taxpayer, inventories shall be taken by such taxpayer upon such basis as the Com-

missioner, with the approval of the Secretary, may prescribe as conforming as nearly as may be to the best accounting practice in the trade or business and as most clearly reflecting the income."

The regulations involved are Regulations 45, arts. 22-24, the material portions of which are as follows:

"Art. 22. Computation of net income.—Net income must be computed with respect to a fixed period. Usually that period is twelve months and is known as the taxable year . . . The time as of which any item of gross income or any deduction is to be accounted for must be determined in the light of the fundamental rule that the computation shall be made in such a manner as clearly reflects the taxpayer's income . . ."

"Art. 23. Bases of computation.—(1) Approved standard methods of accounting will ordinarily be regarded as clearly reflecting income . . ."

"Art. 24. Methods of accounting.—It is recognized that no uniform method of accounting can be prescribed for all taxpayers, and the law contemplates that each taxpayer shall adopt such forms and systems of accounting as are in his judgment best suited to his purpose. . . .

(1) In all cases in which the production, purchase or sale of merchandise of any kind is an income-producing factor inventories of the merchandise on hand (including finished goods, work in process, raw materials and supplies) should be taken at the beginning and end of the year and used in computing the net income of the year; . . ."

The provisions quoted clearly state the following propositions: (1) that it is the income *realized by the taxpayer within the taxable year* which is to be taxed; and (2) that standard

accounting practice is ordinarily to be followed in determining this income.

According to standard accounting practice, inventories are a part of the quick assets of a manufacturing corporation. The excess of quick assets over current liabilities constitutes its working capital. The principal purposes of taking inventories and including them among quick assets are to give information to the management in laying out a financial policy; to give information concerning profits earned as a basis for dividends; and to give information to creditors as to what the company has with which to meet their claims. These purposes require that inventories should be treated as something which may be expected to be converted into current funds within a reasonable time for turnover. One of the principal reasons for listing quick assets separately is that creditors have as much right to know the availability of funds for meeting their debts when due as they have to know the ultimate value of the debts.

If the officers of the petitioner had applied to a bank for a loan on December 31, 1918, and had obtained it on a statement that the inventories on hand, taken on the basis of "cost or market whichever is lower" were worth $732,088.62, knowing that they were worth as merchandise only $231,615.43, could the transaction be defended as honest? Suppose that the owners of a corporation which had inventories under suspended contracts like the petitioner's had, at the end of 1918, sold their stock to the public through the mails and had put out statements for the purpose showing that they had inventories taken at cost or market whichever was lower, to the amount of $732,088.62. Suppose also that it appeared that the inventories had a market value of only $231,615.43, and that the balance of the alleged value was made up of claims against the United States for failure to perform the contracts which, by law, were not assignable and which would require years of time, difficult and uncertain negotiations, and

the expenditure of a large amount of money before anything could be realized from them. Suppose that under these circumstances the owners were indicted for fraudulent use of the mail and convicted. Would such a conviction be set aside on the ground that as a matter of law the inventories were properly valued at $732,088.62?

It is submitted that in the case at bar the inventories in question should be valued on the same basis for income tax purposes as they would be for other purposes and therefore that they should have been valued at their market value.

d. The regulations which relate to the valuation of inventories and to the proceeds of the settlement of claims on Government contracts require that these inventories be valued at their market value.

The regulations involved are Regulations 45, articles 1582–1584 as amended by Treasury Decision 3296, and Regulations 65, article 50, which was in force when the petitioner's tax was determined in 1926. Articles 1582–1584 of Regulations 45 are identical with articles 1612–1614 of Regulations 65 which are printed in full as a part of the petition filed in the Court of Claims (R. 19–23). The portions of these regulations which have a direct bearing on the issue are as follows:

> "Art. 1582. Valuation of inventories.— The Act provides two tests to which each inventory must conform: (1) It must conform as nearly as may be to the best accounting practice in the trade or business, and (2) it must clearly reflect the income. It follows, therefore, that inventory rules cannot be uniform, but must give effect to trade customs which come within the scope of the best accounting practice in the particular trade or business. . . . An inventory that can be used under the best accounting practice in a balance sheet showing the financial position of the taxpayer can, as a general rule, be regarded as clearly reflecting his income.

"The basis of valuation most commonly used by business concerns and which meets the requirements of the Revenue Act is (a) cost or (b) cost or market, whichever is lower. (For inventories by dealers in securities, see article 1585.) Any goods in an inventory which are unsalable at normal prices or unusable in the normal way because of damage, imperfections, shop wear, changes of style, odd or broken lots, or other similar causes, including second-hand goods taken in exchange, should be valued at bona fide selling prices less cost of selling whether basis (a) or (b) is used, or if such goods consist of raw materials or partly finished goods held for use or consumption, they shall be valued upon a reasonable basis, taking into consideration the usability and the condition of the goods, but in no case shall such value be less than the scrap value . . .

"Art. 1584. Inventories at market.— Under ordinary circumstances, and for normal goods in an inventory, 'market' means the current bid price prevailing at the date of the inventory for the particular merchandise in the volume in which usually purchased by the taxpayer, and is applicable in the cases (a) of goods purchased and on hand, and (b) of basic elements of cost (materials, labor, and burden) in goods in process of manufacture and in finished goods on hand; exclusive, however, of goods on hand or in process of manufacture for delivery upon firm sales contracts (i.e., those not legally subject to cancellation by either party) at fixed prices entered into before the date of the inventory, which goods must be inventoried at cost. Where no open market exists or where quotations are nominal, due to stagnant market conditions, the taxpayer must use such evidence of a fair market price at the date or dates nearest the inventory as may be available, such as specific purchases or sales by the taxpayer or others in reasonable volume and made

in good faith, or compensation paid for cancellation of contracts for purchase commitments. . . ."

The material portion of article 50 of Regulations 65 reads as follows:

> "Art. 50. When included in gross income.— Gains, profits and income are to be included in the gross income for the taxable year in which they are received by the taxpayer, unless they are included when they accrue to him in accordance with the approved method of accounting followed by him. See articles 21–24. If a person sues in one year on a pecuniary claim or for property, and money or property is recovered on a judgment therefor in a later year, income is realized in that year, assuming that the money or property would have been income in the earlier year if then received . . . *Such items as claims for compensation under canceled Government contracts constitute income for the year in which they are allowed or their value is otherwise definitely determined.*" (Italics ours.)

It is submitted that the regulations required the petitioner's inventories to be valued at their market value on December 31, 1918. In the Court below the respondent relied on article 1584 as supporting the Commissioner's valuation, claiming that the "firm sales contract" exception found in that article applied; that the cost of the goods was received in the settlements, and that therefore the regulations had been followed in effect by valuing the goods at the amounts so received. The Court of Claims, having first assumed that the *original contracts* entitled the petitioner to receive cost for these inventories (an erroneous assumption—see this brief, pp. 28–33), treated the case as one of "firm sales contracts" (R. 97). It is submitted that under the regulations the "firm sales contracts" exception does not apply.

In the first place, the sentence at the beginning of article

1584, in which the "firm sales contracts" exception is found, applies only to *normal* goods. As appears from article 1582, "normal" goods are those which are salable at normal prices or usable in the normal way. The petitioner's inventories were not "normal" goods; for the suspension requests had cut off all probability of using them in the normal way. It follows that the "firm sales contracts" exception is not one which applies to the petitioner's inventories. The provisions of the regulations which apply to these inventories are those in article 1582, under which an inventory may be valued at cost or market whichever is lower, and must conform as nearly as may be to the best accounting practice in the trade or business and must clearly reflect the income; and also the provisions of article 1584 to the effect that where no open market exists or where quotations are nominal, due to stagnant market conditions, the taxpayer must use the best available evidence of a fair market price at the date or dates nearest the inventory.

In the second place, the "firm sales contracts" exception in art. 1584, by its own terms, applies only to "goods on hand or in process of manufacture for delivery upon firm sales contracts (i.e. those not legally subject to cancellation by either party) at fixed prices entered into before the date of the inventory; . . ." The inventories in question differ from those described by the language quoted in three respects:

1. They were not goods on hand *for delivery*; for at the end of the year 1918 the parties knew that they would never be made into finished articles, and whether the United States would take delivery of them as a part of the settlement of the contracts was wholly uncertain. (See this brief, pp. 28–35.)

2. On December 31, 1918, the contracts were not "firm sales contracts" as defined by article 1584 in the words "those not legally subject to cancellation by either party." Performance under every contract had been stopped by agreement. If, as the regulations recognize, even an unexercised right to cancel destroys the exception, accomplished suspension of production is certainly inconsistent with a "firm sales contract."

3. The contracts as they apply to these inventories were not contracts "at fixed prices entered into before the date of the inventory." The only contracts in existence on December 31, 1918, which called for delivery of goods at fixed prices were the original contracts, and the goods which they called for were completed articles. The cancellation clauses which might have applied to the inventories were inoperative, as has been shown above. (See this brief, pp. 28–33.) In the events which happened, the only contracts which provided for the payment for these materials at fixed prices were the settlement contracts made in 1920–1922. These were not made "before the date of the inventory."

Furthermore, the possible claims which the petitioner had on account of the failure of the respondent to perform the original contracts are, under the regulations, clearly not income in 1918. Article 50 of Regulations 65, which was in force when the petitioner's taxes were settled, expressly provided:

> "*Such items as claims for compensation under canceled Government contracts constitute income for the year in which they are allowed or their value is otherwise definitely determined.*" (Italics ours.)

This article is clearly in accord with the plan of taxation on which the revenue acts are based, as appears from a recent decision of this Court.

Burnet v. *Sanford & Brooks Co.*, 282 U. S. 359.

In that case the taxpayer carried on work under a dredging contract with the United States in the years 1913 to 1915. It reported current payments received under the contract in its returns for the years 1913–1916, inclusive. Subsequently it brought suit against the United States upon the contract, and in 1920 recovered a final judgment and collected it. The amount recovered in 1920 was the equivalent of the losses

suffered in doing the work in earlier years. The taxpayer contended that the transaction should be taken as a whole and that as it had made no net gain from the contract on this basis, the 1920 recovery was not income. The Court held that this recovery should be included in income for 1920, for the reason that the system of taxation contained in the income tax laws was based on annual accounting periods rather than on following through particular transactions.

> "The Sixteenth Amendment was adopted to enable the government to raise revenue by taxation. It is the essence of any system of taxation that it should produce revenue ascertainable, and payable to the government, at regular intervals. Only by such a system is it practicable to produce a regular flow of income and apply methods of accounting, assessment, and collection capable of practical operation. It is not suggested that there has ever been any general scheme for taxing income on any other basis." (*Burnet* v. *Sanford & Brooks Co.*, 282 U. S. 359 at 365.)

In the case at bar the petitioner had at the end of 1918 inventories worth as merchandise $231,615.43, and also possible claims for breach of contract the value of which was uncertain. (See this brief, pp. 33–35.) By valuing these inventories at $732,088.62, the Commissioner included in income for the year 1918 $500,473.19 which was nothing but the proceeds of claims for the cancellation of the contracts which were not liquidated or settled until several years later. Under article 50 these proceeds should have been included in the income for later years and not in 1918 income.

e. The argument that valuing the inventories at market permits the petitioner to take a loss before it is sustained is not valid.

The objection to this argument is that it overlooks the distinction between *inventories*, which, according to the best

accounting practice as exemplified in the "cost or market whichever is lower" method, should be brought down annually to actual current values, and *capital assets*, which should be carried at cost less depreciation (or exhaustion or obsolescence) until they are sold or otherwise disposed of. The very purpose of the regulations in permitting the use of the "cost or market" valuation of inventories is to give the taxpayer the right to value them at prices less than cost when the market value is below cost.

C. The statutes and regulations should be liberally construed in favor of the taxpayer.

In the case at bar it is submitted that the statutes and regulations sustain the petitioner's contentions. If any doubt arises, however, they should be liberally construed in favor of the taxpayer (*Burnet* v. *Niagara Falls Brewing Co.*, 282 U. S. 648, at 654, and cases cited). It is respectfully submitted that the Court of Claims failed to observe this principle of construction.

VII.

THE AMOUNT OF INTEREST TO WHICH THE PETITIONER IS ENTITLED.

The statute involved is section 615 of the Revenue Act of 1928, which reads as follows:

> "(b) In any judgment of any court rendered (whether against the United States, a collector or deputy collector of internal revenue, a former collector or deputy collector, or the personal representative in case of death) for any overpayment in respect of any internal-revenue tax, interest shall be allowed at the rate of 6 per centum per annum upon the amount of the overpayment, from the date of the payment or collection thereof to a date preceding the date of the refund check by not more than thirty days, such date

to be determined by the Commissioner of Internal Revenue."

Of the total tax of $1,152,123.53 assessed upon the petitioner and paid by it, $642,914.24 was an additional tax which was paid on March 31, 1926. The balance, $509,209.29, was the original 1918 tax which was paid on or before June 15, 1919 (Special Findings 3, 4, 6, R. 59–60). The judgment of the Court of Claims orders a refund of $160,978.83 with interest. The difference between the total additional tax ($642,914.24) and the refund ordered ($160,978.83) is $481,935.41. Any additional recovery to which the petitioner is entitled should, therefore, be treated, to the extent of $481,935.41, as a recovery of an overpayment of the additional tax which was paid on March 31, 1926, and any amount in excess of that as a recovery on account of the original tax paid on June 15, 1919.

CONCLUSION.

For the reasons which have been stated, it is submitted that in addition to the relief already given in the Court of Claims, the valuation of the petitioner's inventories under the contracts with the United States on December 31, 1918, should be reduced by the difference between the figure used by the Commissioner ($732,080.62) and their market value ($231,615.43) or $500,473.19; that the petitioner's net income for 1918, as determined by the Commissioner, should be reduced by the same amount; that such income should be further reduced by $327,937.35 because of the deduction to which the petitioner is entitled on account of the cost of its buildings erected on leased land; and that the judgment entered for the petitioner in the Court of Claims should be increased by an amount equal to 82.4% of such reductions of income together with interest as provided by the statute.

HARRY LEBARON SAMPSON,
Counsel for the Petitioner.

APPENDIX.

Regulations 45 (1920 ed.) articles 109, 143, 161, 162 and 165 provide as follows:

Art. 109. Rentals. — Where a leasehold is acquired for business purposes for a specified sum, the purchaser may take as a deduction in his return an aliquot part of such sum each year, based on the number of years the lease has to run. Taxes paid by a tenant to or for a landlord for business property are additional rent and constitute a deductible item to the tenant and taxable income to the landlord, the amount of the tax being deductible by the latter. The cost borne by a lessee in erecting buildings or making permanent improvements on ground of which he is lessee is held to be a capital investment and not deductible as a business expense. In order to return to such taxpayer his investment of capital, an annual deduction may be made from gross income of an amount equal to the total cost of such improvements divided by the number of years remaining of the term of lease, and such deduction shall be in lieu of a deduction for depreciation. If the remainder of the term of lease is greater than the probable life of the buildings erected, or of the improvement made, this deduction shall take the form of an allowance for depreciation. (See article 48.)

Art. 143. Loss of useful value. — When through some change in business conditions the usefulness in the business of some or all of the capital assets is suddenly terminated, so that the taxpayer discontinues the business or discards such assets permanently from use in the business, he may claim as a loss for the year in which he takes such action the difference between the cost or the fair market value as of March 1, 1913, of any asset so discarded (less any depreciation sustained) and its salvage value remaining. This exception to the rule requiring a sale or other

disposition of property in order to establish a loss requires proof of some unforeseen cause by reason of which the property must be prematurely discarded, as, for example, where an increase in the cost of or other change in the manufacture of any product makes it necessary to abandon such manufacture, to which special machinery is exclusively devoted, or where new legislation directly or indirectly makes the continued profitable use of the property impossible. This exception does not extend to a case where the useful life of property terminates solely as a result of those gradual processes for which depreciation allowances are authorized. It does not apply to inventories or to other than capital assets. The exception applies to buildings only when they are permanently abandoned or permanently devoted to a radically different use, and to machinery only when its use as such is permanently abandoned. Any loss to be deductible under this exception must be charged off on the books and fully explained in returns of income. But see articles 181–189.

Art. 161. Depreciation.—A reasonable allowance for the exhaustion, wear and tear and obsolescence of property used in the trade or business may be deducted from gross income. For convenience such an allowance will usually be referred to as depreciation, excluding from the term any idea of a mere reduction in market value not resulting from exhaustion, wear and tear or obsolescence. The proper allowance for such depreciation of any property used in the trade or business is that amount which should be set aside for the taxable year in accordance with a consistent plan by which the aggregate of such amounts for the useful life of the property in the business will suffice, with the salvage value, at the end of such useful life to provide in place of the property its cost, or its value as of March 1, 1913, if acquired by the taxpayer before that date. See further articles 839 and 844.

Art. 162. Depreciable property.—The necessity for depreciation allowance arises from the fact that certain property used in the business gradually approaches the point where its usefulness is exhausted. The allowance should be confined to property of this nature. In the case of tangible property, it applies to that which is subject to wear and tear, to decay or decline from natural causes, to exhaustion, and to obsolescence due to the normal progress of the art, as where machinery or other property must be replaced by a new invention, or due to the property becoming inadequate to the growing needs of the business. It does not apply to inventories or to stock in trade; nor to land apart from the improvements or physical development added to it. It does not apply to bodies of minerals which through the process of removal suffer depletion, other provision for this being made in the statute. See articles 201–237. Property kept in repair may, nevertheless, be the subject of a depreciation allowance. See article 103. The deduction of an allowance for depreciation is limited to property used in the taxpayer's trade or business. No such allowance may be made in respect of automobiles or other vehicles used chiefly for pleasure, a building used by the taxpayer solely as his residence, nor in respect of furniture or furnishings therein, personal effects, or clothing; but properties and costumes used exclusively in a business, such as a theatrical business, may be the subject of a depreciation allowance.

Art. 165. Method of computing depreciation allowance.—The capital sum to be replaced should be charged off over the useful life of the property either in equal annual installments or in accordance with any other recognized trade practice, such as an apportionment of the capital sum over units of production. Whatever plan or method of apportionment is adopted must be reasonable and should be described in the return.

INDEX.

PAGE

I. Reply to the argument for the respondent relating to the deduction for cost of buildings erected on leased land 1

A. Whether section 234(a) (8) by implication limits the deductions contained in subsection (7) 1

B. Whether termination of the war prevented the use of the buildings "for the purposes for which they were constructed" 7

C. Whether the case at bar presents merely an ordinary fluctuation in value 9

D. Whether a deduction of 50% of the cost of the buildings in 1918 is fair 9

II. Reply to the argument for the respondent concerning the valuation of the petitioner's inventories 10

A. Whether the contracts which the petitioner had in December, 1918, "secured the petitioner against loss" on its inventories 10

B. Whether subsequent events affect the value of the materials on December 31, 1918 11

C. Whether all that remained to be done on December 31, 1918, in order to entitle the petitioner to be paid for its inventories, was the accounting required to compute the price 11

D. Whether the Commissioner acting through his subordinates is bound to follow the regulations 12

CASES CITED.

	PAGE
Burnet *v.* Niagara Falls Brewing Co., 282 U. S. 648	4
Burnet *v.* Sanford & Brooks Co., 282 U. S. 359	11
Elliott *v.* United States, 16 F. 2d 164	7
McCreery *v.* Commissioner, 4 B.T.A. 967	11
Mutual Chemical Company of America *v.* Commissioner, 12 B.T.A. 578	10
V. Loewers Gambrinus Brewery Co. *v.* Anderson, 282 U. S. 638	2, 4, 6

STATUTES AND REGULATIONS CITED.

	PAGE
Revenue Act of 1918 (40 Stat. 1057): Secs. 234(a) (4), (7), (8)	1
Revenue Act of 1916 (39 Stat. 767): Sec. 12(a)	2

Supreme Court of the United States.

OCTOBER TERM, 1931.

UNITED STATES CARTRIDGE COMPANY, PETITIONER.
v.
THE UNITED STATES.
No. 348.

REPLY BRIEF FOR THE PETITIONER.

I.

Reply to the argument for the respondent relating to deduction for cost of buildings erected on leased land.

A. The respondent's brief contains an argument which is made for the first time in this Court. No similar contention has ever been made in the case before. The respondent argues that the provisions of § 234 (a) (8) relating to amortization show that Congress did not intend to allow a deduction for obsolescence to a taxpayer whose buildings were erected for war purposes before the United States entered the war; and that this is shown both by the language of subsection (8) and by its legislative history.

It is submitted that, for the reasons stated below, this contention cannot be supported.

Sections 234(a) (4), (7) and (8) of the Revenue Act of 1918 provide for deductions from gross income of corporations including the following:

"(4) Losses sustained during the taxable year and not compensated for by insurance or otherwise;

* * * * * * * *

(7) A reasonable allowance for the exhaustion, wear and tear of property used in the trade or business, including a reasonable allowance for obsolescence;

(8) In the case of buildings, machinery, equipment, or other facilities, constructed, erected, installed, or acquired on or after April 6, 1917, for the production of articles contributing to the prosecution of the present war, and in the case of vessels constructed or acquired on or after such date for the transportation of articles or men contributing to the prosecution of the present war, there shall be allowed a reasonable deduction for the amortization of such part of the cost of such facilities or vessels as has been borne by the taxpayer, but not again including any amount otherwise allowed under this title or previous acts of Congress as a deduction in computing net income. At any time within three years after the termination of the present war the Commissioner may, and at the request of the taxpayer shall, reëxamine the return, and if he then finds as a result of an appraisal or from other evidence that the deduction originally allowed was incorrect, the taxes imposed by this title and by Title III for the year or years affected shall be redetermined, and the amount of tax due upon such redetermination, if any, shall be paid upon notice and demand by the collector, or the amount of tax overpaid, if any, shall be credited or refunded to the taxpayer in accordance with the provisions of section 252;"

The legislative history of the provisions relating to deductions for depreciation, exhaustion, wear and tear, and obsolescence is stated in the opinion in *V. Loewers Gambrinus Brewery Co.* v. *Anderson*, 282 U. S. 638, at p. 643. The only provisions on the subject in the Revenue Act of 1916 are found in section 12(a). The material portion of this section is as follows:

"Second. All losses actually sustained and charged off within the year and not compensated by insurance or otherwise, including a reasonable allowance for the exhaustion, wear and tear of property arising out of its use or employment in the business or trade;" (Revenue Act of 1916, § 12(a), 39 Stat. 767.)

Under these provisions a deduction was allowed for loss of useful value which became complete during a given tax year. In other words, obsolescence was deductible when it reached the point of obsoleteness, but not before.

The attitude of the Bureau of Internal Revenue is shown by the following quotation from the letter of Commissioner W. H. Osborn to the Corporation Trust Company, dated September 19, 1916, and printed at page 254 in the 1918 Income Tax Service of the Corporation Trust Company.

"It is not possible in advance to determine when a piece of machinery, equipment or even a building will become obsolete. In other words, obsolescence cannot be anticipated and an annual deduction to take care of possible obsolescence cannot be allowed.

"The rules of this office contemplate that annual deductions for depreciation may be made to provide for loss due to wear and tear, the amount of such deduction to be determined upon the basis of the probable life of the property. If it shall occur that the property becomes obsolete or worthless before its estimated probable life shall have expired, a deduction representing the difference between the cost of the property and the amount previously charged off on account of depreciation may be deducted as a loss, this amount being a deduction due to the obsolescence of the property."

Abandonment of the use of the property was made by the Commissioner a condition precedent to the allowance for loss

of useful value. Whether he had the right to impose this condition need not be discussed, as the changes contained in the 1918 act make this question immaterial.

The second type of loss of useful value is that found in the brewery cases. In those cases it had become apparent in the year 1918 that after a certain time in a later year the plants could not be used for their original purposes. In such a case no loss for 1918 could have been deducted under the language in the Revenue Act of 1916 as a loss "sustained and charged off within the year," for the reason that the loss had not yet occurred in 1918. Congress, in enacting the Revenue Act of 1918 which imposed taxes running up to 82.4% of the net income, recognized the justice of permitting such a deduction, and did so in section 234(a) (7), which made an allowance for obsolescence in process, whether or not it ripened into obsoleteness within the year.

V. Loewers Gambrinus Brewery Co. v. *Anderson*, 282 U. S. 638.
Burnet v. *Niagara Falls Brewing Co.*, 282 U. S. 648.

There still remained a third type of case which was not within either section 234(a) (4) or section 234(a) (7). Various corporations had spent enormous sums after the United States entered into the war for facilities constructed for the production of articles contributing to the prosecution of the war. In many cases it was impossible to predict when their usefulness would end. Shipping, for instance, was in great demand after the Armistice, not only to bring home the army and its property, but also to replace the large tonnage which had been lost. The Shipping Board and the Emergency Fleet Corporation were active for a long time. Airplane construction was also continued until long after the Armistice, as the army had an insufficient supply of planes. At the end of 1918 no one could tell even approximately when these and certain other activities would stop. Consequently there was no adequate basis

on which to compute obsolescence for the year 1918 on such facilities. Owners faced ruin, however, if they were to be taxed on their 1918 income, computed without any allowance for obsolescence, at rates running up to 82.4% and the profits from subsequent years should prove insufficient to pay for the cost of the facilities. To cover such cases Congress by subsection 234(a) (8) provided for an additional allowance called "amortization," limiting it, however, to facilities acquired on or after April 6, 1917. Subsection 234(a) (8) departed from the general plan of the Revenue Acts, which took into account only events happening within the tax year, and provided for the deduction of estimated amounts based on loss of useful value expected to take place in the future, making an additional provision for a revision of the estimates at any time within three years after the termination of the war (meaning the official termination, which eventually took place on March 3, 1921). The subsection was reënacted in substance in the Revenue Act of 1921 as section 234(a) (8), but was omitted in the later Revenue acts. Under this subsection, either the Commissioner or the taxpayer could have a redetermination of the amount of the "amortization" before March 3, 1924, in the light of events as they had then turned out.

The meaning of the word "amortization" is one which has undergone a very recent change. The third revision of Bouvier's Law Dictionary, published in 1914, defines the term as follows:

> "Amortization. An alienation of lands or tenements in mortmain.
>
> It is used colloquially in reference to paying off a mortgage or other debt by instalments, or by a sinking fund."

Webster's New International Dictionary, published in 1925, contains the further definition

> "Amortize. 3. To clear off, liquidate, or otherwise extinguish, as a debt, usually by a sinking fund. Hence:

a. To extinguish (a premium or a discount involved in the purchase of a security) by periodically charging off a portion (of the premium) or crediting a portion (of the discount) so as to bring the value to par at maturity, the transfer being made respectively from income to investment or vice versa. b. Loosely, to bring the value of (a security) to par in this way."

Accountants customarily use this word to include any method by which a reserve is set up from income to provide against an anticipated loss of value of particular assets. It is undoubtedly used in this sense in section 234(a).

There is no good ground for the argument that because this extraordinary kind of deduction for anticipated loss of value was limited by subsection 234(a) (8) to cases of facilities acquired on or after April 6, 1917, the other deductions contained in subsections (4) and (7) must be held to be so limited. If the argument for the respondent that subsection (8) by implication denies any deduction for obsolescence in the case at bar were sound, it would follow logically that it would deny also any deduction for exhaustion or wear and tear, all of which are specified in subsection (7) along with obsolescence. The Commissioner, however, admits that subsection (8) does not have that effect; for he has made an allowance of $86,484.50 to the petitioner for ordinary exhaustion of the leasehold for 1918.

As was said in the opinion in *V. Loewers Gambrinus Brewery Co.* v. *Anderson*, 282 U. S. 638, in dealing with the claim of another alleged limitation of subsection (7) by implication, "The language of section 234(a) (7) is broad enough to include all obsolescence from whatever cause . . . The cost of plant depreciation, *i.e.*, exhaustion, wear, tear and obsolescence, is a part of operating expenses necessary to carry on a manufacturing business. The gain or loss in any year cannot be rightly ascertained without taking into account the amount of such

cost that is justly attributable to that period of time." (Opinion, pp. 641–643.)

It is reasonable to suppose that Congress in an act which imposed taxes at the high rates contained in the Revenue Act of 1918, intended that income should be "rightly ascertained." Certainly no contrary intention should be imputed by implication.

If Congress had intended to take away from persons who owned war facilities acquired before April 6, 1917, all right to any allowance for obsolescence arising from the ending of the war, the natural way to have done it would have been by a proviso at the end of subsection (7) and not by relying upon an implication to be drawn from subsection (8), which dealt with a deduction called "amortization."

The only reasonable conclusion is that subsection (8) was intended to give additional deductions, and was not intended to restrict those which were given in other subsections. A decision in which this view is clearly stated, and which also illustrates the practical application of the provisions of subsection (8) is *Elliott* v. *United States*, 16 F. 2d 164.

B. The argument is made in the respondent's brief that the termination of the war did not prevent the petitioner from using the buildings "for the purposes for which they were constructed" (p. 18).

In support of this argument it is said that the principal use of them after the war was for the manufacture of commercial ammunition; that they were well adapted for this purpose; and that there was nothing to show at the end of 1918 that this would not be a profitable use.

The answers to this argument are as follows:

In the first place, the buildings were not erected for the purpose of making commercial ammunition. The Company had no use for them except for war production. The petitioner in its war production employed 15,000 persons as against 350 to 400 employed in its commercial business before the war,

and required for its war business five times the space which it had previously used (Special Findings 43, 46, R. 77–79). After the Armistice the petitioner's position with respect to its commercial business was difficult as each of the five munition manufacturers in the country had a capacity much greater than in previous peace times, and each strove to get as much of the business as possible. Competition was severe and keen. The industry was believed to be declining and the only way to get new business was to take it away from competitors (Special Findings 50, 52, R. 81, 82). The buildings could not be rented after the war, as there was no demand for them (Special Finding 51, R. 81). It is clear that the petitioner in trying to get some return from the buildings by using them after 1918 was not using them "for the purpose for which they were constructed."

In the second place the value on December 31, 1918, of the right to use these buildings in the petitioner's peace time business for the remainder of the lease ($190,969.86) has been credited in making up the petitioner's claim. This credit takes into account any allowance which should fairly be made because the buildings were used for ordinary commercial purposes after 1918.

In the third place, the petitioner's claim is not based merely on the fact that it made no profits after 1918. The petitioner's claim for obsolescence was complete at the end of 1918 when it was known that its war business was over. It then had the right to charge off the difference between the depreciated cost of the buildings ($605,391.75) and their residual value ($190,969.86). The findings in this case as to lack of profits in later years are not so much a part of the petitioner's case as they are in the nature of a rebuttal of any possible claim of the respondent that the buildings might, in fact, have been worth more to the petitioner than their residual value. Accordingly, the argument made in the brief for the respondent that no one could tell at the end of 1918 whether the petitioner would

make profits in the future does not affect the issue. It is to be noted that this same argument, if valid, would have prevented any allowance for obsolescence in the cases of the brewery companies which continued to use their plants to make soft drinks.

C. It is argued in the brief for the respondent that the case at bar presents merely such a fluctuation in value *of property* as results from a falling off in demand due to a business depression, and that such fluctuations are not the basis of a deduction for absolescence. This argument overlooks the distinction between fluctuations in the volume of a business due to trade conditions, which are in their nature temporary, and changes which result in the discontinuance of demand for certain kinds of goods. There was no greater prospect in December, 1918, that the petitioner's buildings would ever be used again to make war ammunition than there was that brewery buildings would be used again to make beer after January, 1920. If absolescence is allowable in the latter case, it is equally allowable in the former.

D. It is argued in the respondent's brief that the petitioner's method, which takes a deduction in the year 1918 of approximately 50% of the cost of the buildings, is unfair (p. 21). The answer is that *the reduction in value which took place in 1918 amounted to about 50% of the cost of the buildings.* Can anyone who remembers the conditions which prevailed at the beginning of 1918 have any doubt that a complete and relatively new small arms ammunition plant actually engaged in production had a value on January 1, 1918, at least as great as its cost less depreciation, which is the value used in the case at bar? The fact that the drop from this value to the residual value of $190,969.86 all happened in 1918 is the best of reasons for allowing an equivalent deduction in that year.

II.

Reply to the argument for the respondent concerning the valuation of the petitioner's inventories.

The points made in the brief for the respondent are for the most part covered by the petitioner's original brief. A few of them will be noted below in order to clarify the issues raised.

A. The argument for the respondent is based throughout on the proposition that the contracts which the petitioner had in December, 1918, "secured the petitioner against loss" on its inventories (pp. 21–32).

In so far as this contention is based on a claim that the original contracts as they stood on December 31, 1918, gave the petitioner the right to deliver its inventories and to be paid for them in regular course of business because (it is claimed) the suspension notices were elections by the Chief of Ordnance to exercise the options contained in the cancellation clauses of the contracts, the answer is found in the petitioner's original brief at pages 28–35, in which it is shown that the petitioner was not "secured" in that sense. If, as was really the case, the petitioner had on December 31, 1918, no right to deliver these inventories and to be paid for them, but had then to depend only on future negotiations, or a suit in the Court of Claims for breach of contract, in order to secure reimbursement for the difference between their cost and their market value, the decision on which the respondent relies (*Mutual Chemical Company of America* v. *Commissioner*, 12 B.T.A. 578) has no application. That was clearly a case in which a contract was in course of performance in the ordinary way, and the language in the Board of Tax Appeals was intended to apply only to such a case. This appears in the extract from the opinion printed in the respondent's brief at page 23, in which reference is made to "the following year when the sales were executed."

If the respondent by the expression "secured against loss"

means to include such right as the petitioner had to treat the contracts as broken and to recover damages for the breach by suit in the Court of Claims, it is submitted that the existence of such rights would not sustain the proposition that the inventories must be valued at cost. Even if it be conceded for the sake of the argument that the petitioner had a valid cause of action against the United States, it does not follow that the amount which could be recovered at the end of the litigation should be treated as income of the year 1918.

Burnet v. *Sanford & Brooks Co.*, 282 U. S. 359.
See authorities cited in the petitioner's brief, pp. 36–47.

The Commissioner has, however, by taking the inventories at cost, valued them at a figure which includes their market value plus any possible damages recoverable for breach of contract on account of these inventory items.

B. The argument is made in the brief for the respondent that subsequent events may be considered in determining the value of the inventories of December 31, 1918. It is contended that the settlement contracts made in the years 1920 to 1922, by which most of the materials were taken over and paid for at cost, were the best evidence of the value of the materials which was available to the Commissioner (p. 31). It is difficult to see the force of the argument. The issue in this case is whether the petitioner was entitled to value its inventories at market on December 31, 1918. The Court of Claims has specifically found that the market value of these inventories on that date was $231,615.43 (Special Finding 42, R. 77). That finding cannot be overturned by proof of what was obtained in the later settlements.

C. The brief for the respondent also refers to words used in the opinion of the Court of Claims to the effect that the petitioner had at the end of 1918 an enforcible demand for the cost of the goods in the form of a positive covenant to pay the same; and in this connection *McCreery* v. *Commissioner*,

4 B.T.A. 967 is cited (pp. 31–32). If the case at bar were one in which on December 31, 1918, the petitioner had contracted to sell these inventories and the United States had agreed to accept and to pay for them on terms specified in the contracts, and if all that remained to be done had been the accounting necessary to calculate the number of dollars payable (as was true in the *McCreery* case), the language in the Court of Claims and the decision in the *McCreery* case might have a bearing on the issue. The difficulty with the argument in the case at bar is, as has already been shown in the petitioner's brief, that no such situation existed on December 31, 1918 (Brief, pp. 28–35).

D. The brief for the respondent also suggests that the Commissioner made the regulations (p. 21); that his interpretation of the regulations is of great weight; that evidently he believed that the contracts were "firm sales contracts" because he valued the inventories at cost; and that his ruling should not be upset, even if inconsistent with the language of the regulations (p. 27). This argument overlooks several considerations. The first is that the Commissioner cannot make regulations by himself, but only with the approval of the Secretary of the Treasury (Revenue Act of 1918, section 203). The regulations, when so made and approved, are as binding on the Commissioner as on anyone else. It is further to be borne in mind that the Commissioner, in applying the regulations to individual cases, acts through large numbers of subordinates. As everyone knows, it is their interpretation of the regulations which is applied in any specific case, including the case at bar. If each subordinate has the right not to apply the regulations as they stand, and to depart from the language of them in order to carry out what he conceives to be their probable purpose, there is an end to all uniformity of administration. The argument for the respondent alleges that the regulations when promulgated "have the force of law and are as binding upon the courts as if incorporated in the statute

itself." (Brief, pp. 21–22.) It would be a most extraordinary situation if the courts were bound to follow the regulations as they stood, but the subordinates of the Commissioner might depart from them. It is submitted that the sound rule that statutes are to be construed according to the plain meaning of the words used applies equally to regulations.

HARRY LEBARON SAMPSON,
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INDEX

	Page
Opinion below	1
Jurisdiction	1
Questions presented	2
Statutes and regulations	2
Statement	2
Discussion	7
Conclusion	15
Appendix (Statutes and Regulations)	16–22

CITATIONS

Cases:	
Burnet v. *Niagara Falls Brewing Co.*, 282 U. S. 648	8
College Point Boat Corp. v. *United States*, 267 U. S. 12	12
Ewing Thomas Converting Co. v. *McCaughn*, 43 F. (2d) 503, certiorari denied, 282 U. S. 897	14
McCreery v. *Commissioner*, 4 B. T. A. 967	14
Producers Fuel Co. v. *Commissioner*, 1 B. T. A. 202	14
Statutes:	
Dent Act of March 2, 1919, c. 94, 40 Stat. 1272	6, 14
Revenue Act of 1918, c. 18, 40 Stat. 1057, 1060, 1077—	
Sec. 203	16
Sec. 234 (a) (4) (7)	16
Miscellaneous:	
Treasury Regulations 45 (1920 ed.), promulgated under the Revenue Act of 1918—	
Art. 109	17
Art. 143	17
Art. 161	18
Art. 162	19
Treasury Regulations 45 (1920 ed.), as amended—	
Art. 1581	20
Art. 1582	20
Art. 1584	21

In the Supreme Court of the United States

OCTOBER TERM, 1931

No. 348

UNITED STATES CARTRIDGE COMPANY, PETITIONER

v.

THE UNITED STATES

ON PETITION FOR A WRIT OF CERTIORARI TO THE COURT OF CLAIMS

MEMORANDUM FOR THE UNITED STATES

The United States does not oppose a review of the question of the asserted right to a deduction for obsolescence.

OPINION BELOW

The opinion of the Court of Claims (R. 88) is reported in 48 F. (2d) 983, and also in 71 C. Cls. 575.

JURISDICTION

The judgment sought to be reviewed was entered June 10, 1931. (R. 200.) The petition for certiorari was filed September 3, 1931. The jurisdiction of this Court is invoked under Section 3 (b) of the Act of February 13, 1925.

QUESTIONS PRESENTED

1. Whether the petitioner, in computing its taxable income for the year 1918, was entitled to a deduction for obsolescence of its interest in certain buildings in excess of the deduction for exhaustion allowed by the Commissioner. The claim of the petitioner is based upon the fact that the value of its interest in these buildings, which it had erected on leased land for the purpose of manufacturing ammunition for war, declined greatly because of the termination of that business after the armistice. The facts relating to this question are stated on pp. 3–5, *infra*.

2. Whether, in computing petitioner's taxable income for the year 1918, the Commissioner erred in the valuation which he placed upon the petitioner's inventory as of December 31, 1918. This question depends upon the proper method of valuing certain material which was being manufactured for the Government. The facts relating to this question are stated on pp. 5–7, *infra*.

STATUTES AND REGULATIONS

The applicable statutes and regulations appear in the Appendix, pp. 16–22, *infra*.

STATEMENT

This suit was brought to recover alleged overpayments of the petitioner's 1918 income and profits taxes amounting to $843,589.12. The petitioner's claim was predicated upon three alleged errors of the Commissioner. (R. 15–43.) The Court of Claims

sustained the contention of the petitioner as to one of the alleged errors and entered judgment for petitioner for $160,978.83 and interest. (R. 200.) No question as to this point is here involved.

Prior to 1914 the petitioner was engaged in the manufacture of ammunition for commercial purposes, its business being carried on largely in rented buildings. (R. 77.) In 1914, for the purpose of filling war orders which it had received and expected to receive, the petitioner began the construction of certain buildings on land of its lessor, under an agreement whereby it was to occupy such buildings, rent free, for ten years, at the end of which term the buildings were to become the property of the lessor. (R. 77–78.) These buildings were erected, largely in 1915 and 1916, at a cost of $802,499.49. (R. 78.)

When the petitioner erected the buildings it had no use for them except for war purposes. During the war the petitioner used them to their full capacity in a large and profitable ammunition business. (R. 78–79.) After the armistice in 1918 the petitioner received no new orders for military ammunition and did not expect any. It had no expectation of continuing the production of military ammunition after the war and did not do so to any material extent. It continued its commercial ammunition business after the war, and as it had more space in its buildings than it needed for that business, it used all of the remaining space in the manufacture of radiators, radiator tubes, motors, paper

boxes, and other articles. (R. 81.) The volume of this other business was small as compared to the petitioner's commercial ammunition business. (R. 81–82.) The petitioner realized no net return from this other business, and it made no profit on its commercial ammunition business during any of the years 1919 to 1924, inclusive. (R. 82.)

After the armistice there was no demand for the new buildings and they could not be rented. Some of these buildings had been incorporated into the old buildings, so that the two groups had to be used as a unit. (R. 81, 86.) During the period from 1914 to 1924 the petitioner was a tenant at will of all the buildings which it occupied, except the new buildings erected in 1914 and 1915. (R. 87.)

From a mechanical point of view there is no difference between the manufacture of military ammunition and commercial ammunition except that the same machinery will produce more military ammunition because there are fewer sizes and types of the former than of the latter. (R. 82.)

In the petitioner's income and profits tax returns for the years 1914 and 1917, inclusive, the Commissioner allowed deductions for exhaustion of the new buildings totaling $197,107.74. (R. 79.) In its 1918 return the petitioner asserted that the value on December 31, 1918, of its right to use the buildings for peace-time purposes for the remainder of the term of ten years was only $190,969.86, and asserted that it was entitled to deduct from its gross income as the loss of useful value for 1918 the difference

between the depreciated value of the buildings at the beginning of 1918 (i. e., the cost, less depreciation to December 31, 1917) and the residual value of the lease, $190,969.86, at the end of 1918. The deduction so claimed amounted to $414,421.89. (R. 79–80.) The Commissioner rejected the claim of the petitioner and allowed a deduction of $86,484.54 for depreciation of the buildings for 1918. The amount of this allowance, as well as the prior allowances totaling $197,107.74, was based upon a rate so calculated that at the expiration of the lease the cost of each building would be extinguished by equal annual installments. (R. 80.)

The value of the petitioner's right to use the new buildings for the six years of its lease remaining after December 31, 1918, did not exceed $190,969.86. (R. 82.) In its tax returns for the years 1919 to 1924, inclusive, the petitioner claimed deductions on account of the cost of the buildings aggregating $190,969.86—this amount being allocated proportionately over those years. The Commissioner increased the deductions for these years by $327,937.35, the amount of the deduction which the Commissioner had disallowed for 1918. (R. 80.)

During 1918 the petitioner was engaged in manufacturing ammunition under four contracts with the United States. One of these contracts was made in 1917 and all the others on various dates in 1918 prior to November 11, 1918. (R. 67–68.)

One of these contracts was supplemented by an agreement made December 18, 1918, which was not executed in compliance with the statutory requirements. (R. 132–134.) This was, however, validated by the Dent Act, which was approved on March 2, 1919 (40 Stat. 1272). Each of the contracts contained a provision for cancellation by the Government in the event of the end of the war, and provided that in the event of the termination of the contract the Government would reimburse the petitioner for the cost of worked and unworked materials then on hand. (R. 126, 142, 154, 170.)

In December, 1918, the Government notified the petitioner to suspend production under these contracts, each notice stating that the request was made with a view of negotiating a supplemental contract providing for the cancellation, settlement, and adjustment of the existing contract in a manner which would permit of a more prompt settlement of payment than would be practicable under the existing contract. (R. 69.) Pursuant to these notices the petitioner suspended production under the contracts. (R. 70.) Negotiations for the execution of "settlement contracts" were begun early in 1919 and were continued until 1922. Under final settlement contracts entered into in 1920, 1921, and 1922, the petitioner was paid a total sum of $1,154,618.35 by the United States. (R. 75.)

The fair market value of the worked and unworked materials which the petitioner had on hand on December 31, 1918, applicable to the contracts

here involved, without considering any special value arising from obligations of the United States, was $231,615.43. (R. 76.) The value of these materials on that date, pricing at cost those which were subsequently taken over at cost by the United States, pricing the materials for which the petitioner was paid a part of the cost at the amount which was received therefor under the settlement contracts, and pricing the remainder at the fair market value on December 31, 1918, was $732,088.62. (R. 76.) In valuing the petitioner's inventory at the end of 1918 for the purpose of determining the petitioner's 1918 taxes, the Commissioner valued the materials in question at $732,088.62 (R. 76) and rejected the petitioner's contention that they should have been valued at $231,615.43 (R. 77). Any reduction in the inventory below $732,088.62 would cause an equal reduction in the petitioner's taxable income for 1918. (R. 77.) The petitioner kept its accounts and made its returns upon the basis of the calendar year and upon the accrual basis. (R. 59.)

The Court of Claims held that the Commissioner did not err either in fixing the allowance for exhaustion of the leased buildings or in the computation of the petitioner's inventory. (R. 96–110.)

DISCUSSION

I

The first question involves what seems to be a novel point under the provisions of the revenue acts providing for "a reasonable allowance for

obsolescence." The petitioner contends that the decision below conflicts with that of this Court in *Burnet* v. *Niagara Falls Brewing Co.*, 282 U. S. 648. Without conceding this, we consider that the question whether the principles there enunciated apply to this case is one of sufficient doubt and importance to justify a review by this Court.

If a review is granted, we assume that it will include all questions as to allowances in connection with all of the buildings, including the garage mentioned in Paragraph 56 of the findings. (R. 83.)

II

We suggest that if the writ is granted, review be limited to the question of the allowance for obsolescence claimed by the petitioner, as the other contentions of the petitioner do not seem to us to raise questions worthy of consideration by this Court. The ultimate question raised by these contentions is whether the Commissioner's valuation of the petitioner's inventory as of December 31, 1918, was justified. The petitioner contends that the value should have been fixed at $231,615.43, which the Court of Claims found was "the fair market value of said materials and work in process on December 31, 1918, without taking into consideration any special value of such goods to the plaintiff arising from said contracts [with the Government], if any such special value existed." (R. 76, Par. 41.) The Commissioner's figure, $732,088.62, included

the cost of certain materials for which the Government reimbursed petitioner as the result of settlements arising out of the obligation of the Government to pay such costs upon termination of the contracts.

Section 203 of the Revenue Act of 1918, p. 16, *infra*, provided that when—

> the use of inventories is necessary in order clearly to determine the income of any taxpayer, inventories shall be taken by such taxpayer upon such basis as the Commissioner, with the approval of the Secretary, may prescribe as conforming as nearly as may be to the best accounting practice in the trade or business and as most clearly reflecting the income.

The statute went no further than this.

The regulations promulgated under the Act recognized as a basis of valuation which meets the requirements of the Revenue Act that of "cost or market, whichever is lower." (See Article 1582, as amended, p. 21, *infra*.) The petitioner contends that it was entitled to have its inventory taken on the basis of market value. The court below held that, even if the inventory were taken upon this basis, it would have to be taken subject to the exception in Article 1584 (p. 21, *infra*), which provided that even where the inventory was taken on the basis of "market,"

> goods on hand or in process of manufacture for delivery upon firm sales contracts

> * * * at fixed prices entered into before the date of the inventory * * * must be inventoried at cost.

The court below held that the goods in question were "goods in process of manufacture for delivery upon firm sales contracts at fixed prices", and accordingly held that they were properly inventoried at cost. It based this conclusion upon the fact that each contract between the petitioner and the United States provided, in substance, that in the event of the termination of the war—

> The Chief of Ordnance may * * * notify the Contractor that any part or parts of the articles then remaining undelivered shall not be manufactured or delivered. (R. 125–126, 141, 153, 170.)

and further provided that—

> In event of such complete or partial termination the United States * * * shall pay to the Contractor * * * the cost of materials * * * then on hand in an amount not exceeding the requirements for the completion of this contract. (R. 126, 141–142, 153–154, 170.)

whereupon—

> Title to all such materials and component parts paid for by the United States * * * shall * * * vest in the United States. (R. 126, 142, 154, 170.)

In December, 1918, the Ordnance Department sent the petitioner a notice under each contract requesting the petitioner immediately to suspend

further production, and stating that the request was made with a view to negotiation of a supplemental contract providing for the cancellation, settlement, and adjustment of the existing contract in a manner which would permit of a more prompt settlement and payment than would be practicable under the existing contract. (R. 69.) Pursuant to such notices the petitioner suspended further production under the contracts. (R. 69–70.) By virtue of the notices to suspend production there came into being, prior to December 31, 1918, an obligation on the part of the United States to pay the petitioner the cost of materials then on hand.

The petitioner contends that the contracts were not *cancelled* but merely *suspended,* and that, therefore, the United States did not become liable to pay the cost of the materials until the execution of the final settlement contracts in subsequent years. But reference to the terms of the contracts above quoted will show that the Chief of Ordnance was authorized upon the ending of the war to notify the contractor not to manufacture or deliver any further munitions, and that upon the event of a complete or partial "termination" of manufacture the United States should be liable for the cost of the materials. The Government's obligation under these provisions was not dependent upon a technical cancellation; it arose when work on the contracts was terminated at the request of the United States. The suspension requests (R. 52–56) clearly terminated the produc-

December 31, 1918, of the materials, the Commissioner was not warranted in ignoring intervening events having a legitimate bearing upon the value of the materials. The payment of the sums in question to the petitioner by the United States as the cost of the materials was the very best evidence of such value available to the Commissioner. See *Producers Fuel Co.* v. *Commissioner,* 1 B. T. A. 202; *McCreery* v. *Commissioner,* 4 B. T. A. 967, 979–980; *Ewing Thomas Converting Co.* v. *McCaughn,* 43 F. (2d) 503, certiorari denied, 282 U. S. 897.

The petitioner points out that one of the agreements was not originally executed according to law and apparently argues that consequently it did not become a valid contract until made such, in effect, by the Dent Act of March 2, 1919, and contends that this agreement was not a contract "at fixed prices entered into *before the date of the inventory*" within the meaning of Article 1584. But it was made in 1918 and the Dent Act operated to validate it. The mere fact that that Act was not passed until a short time after the end of the year 1918 would not seem to be important, especially as its effective date was prior to the date fixed by law for the filing of the petitioner's return for 1918. (R. 59.)

Other contentions made by the petitioner are, we believe, in substance answered by what has already been stated. The question presented as to the valuation of petitioner's inventory is one peculiar to the instant case. It arises under the special provisions

of war contracts, is affected by peculiar circumstances affecting the particular taxpayer involved, and is not likely to be one of frequent occurrence. We do not believe that this issue involves any question of general importance or application.

CONCLUSION

We do not oppose the petition in so far as it relates to the claimed deduction for obsolescence, inasmuch as that involves a question as to the application of *Burnet* v. *Niagara Falls Brewing Co.*, 282 U. S. 648. But we suggest that the other points raised are not of sufficient importance to warrant a review by this Court.

Respectfully submitted.

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OCTOBER, 1931.

APPENDIX

STATUTES AND REGULATIONS

The Revenue Act of 1918, c. 18, 40 Stat. 1057, 1060, 1077 provides in part:

> SEC. 203. That whenever in the opinion of the Commissioner the use of inventories is necessary in order clearly to determine the income of any taxpayer, inventories shall be taken by such taxpayer upon such basis as the Commissioner, with the approval of the Secretary, may prescribe as conforming as nearly as may be to the best accounting practice in the trade or business and as most clearly reflecting the income.
>
> * * * * *
>
> SEC. 234. (a) That in computing the net income of a corporation subject to the tax imposed by section 230 there shall be allowed as deductions:
>
> * * * * *
>
> (4) Losses sustained during the taxable year and not compensated for by insurance or otherwise;
>
> * * * * *
>
> (7) A reasonable allowance for the exhaustion, wear and tear of property used in the trade or business, including a reasonable allowance for obsolescence * * *.

Articles 109, 143, 161, 162 of Regulations 45 (1920 edition), promulgated under the Revenue Act of 1918, provide:

ART. 109. *Rentals.*—Where a leasehold is acquired for business purposes for a specified sum, the purchaser may take as a deduction in his return an aliquot part of such sum each year, based on the number of years the lease has to run. Taxes paid by a tenant to or for a landlord for business property are additional rent and constitute a deductible item to the tenant and taxable income to the landlord, the amount of the tax being deductible by the latter. The cost borne by a lessee in erecting buildings or making permanent improvements on ground of which he is lessee is held to be a capital investment and not deductible as a business expense. In order to return to such taxpayer his investment of capital, an annual deduction may be made from gross income of an amount equal to the total cost of such improvements divided by the number of years remaining of the term of lease; and such deduction shall be in lieu of a deduction for depreciation. If the remainder of the term of lease is greater than the probable life of the buildings erected, or of the improvement made, this deduction shall take the form of an allowance for depreciation. (See article 48.)

ART. 143. *Loss of useful value.*—When through some change in business conditions the usefulness in the business of some or all of the capital assets is suddenly terminated, so that the taxpayer discontinues the business or discards such assets permanently from use in the business, he may claim as a loss for the year in which he takes such action the difference between the cost or the fair market value as of March 1, 1913, of any asset so discarded (less any depreciation sustained) and its salvage value remaining. This exception to the rule requiring a sale

or other disposition of property in order to establish a loss requires proof of some unforeseen cause by reason of which the property must be prematurely discarded, as, for example, where an increase in the cost of or other change in the manufacture of any product makes it necessary to abandon such manufacture, to which special machinery is exclusively devoted, or where new legislation directly or indirectly makes the continued profitable use of the property impossible. This exception does not extend to a case where the useful life of property terminates solely as a result of those gradual processes for which depreciation allowances are authorized. It does not apply to inventories or to other than capital assets. The exception applies to buildings only when they are permanently abandoned or permanently devoted to a radically different use, and to machinery only when its use as such is permanently abandoned. Any loss to be deductible under this exception must be charged off on the books and fully explained in returns of income. But see articles 181–189.

ART. 161. *Depreciation.*—A reasonable allowance for the exhaustion, wear and tear and obsolescence of property used in the trade or business may be deducted from gross income. For convenience such an allowance will usually be referred to as depreciation, excluding from the term any idea of a mere reduction in market value not resulting from exhaustion, wear and tear or obsolescence. The proper allowance for such depreciation of any property used in the trade or business is that amount which should be set aside for the taxable year in accordance with a consistent plan by which the aggregate of such amounts for the useful life of

the property in the business will suffice, with the salvage value, at the end of such useful life to provide in place of the property its cost, or its value as of March 1, 1913, if acquired by the taxpayer before that date. See further articles 839 and 844.

ART. 162. *Depreciable property.*—The necessity for a depreciation allowance arises from the fact that certain property used in the business gradually approaches a point where its usefulness is exhausted. The allowance should be confined to property of this nature. In the case of tangible property, it applies to that which is subject to wear and tear, to decay or decline from natural causes, to exhaustion, and to obsolescence due to the normal progress of the art, as where machinery or other property must be replaced by a new invention, or due to the property becoming inadequate to the growing needs of the business. It does not apply to inventories or to stock in trade; nor to land apart from the improvements or physical development added to it. It does not apply to bodies of minerals which through the process of removal suffer depletion, other provision for this being made in the statute. See articles 201–237. Property kept in repair may, nevertheless, be the subject of a depreciation allowance. See article 103. The deduction of an allowance for depreciation is limited to property used in the taxpayer's trade or business. No such allowance may be made in respect of automobiles or other vehicles used chiefly for pleasure, a building used by the taxpayer solely as his residence, nor in respect of furniture or furnishings therein, personal effects, or clothing; but properties and costumes used exclusively in a business, such as

a theatrical business, may be the subject of a depreciation allowance.

Treasury Regulations 45 (1920 edition), promulgated under the 1918 Act, as amended March 3, 1922 (C. B. I–1, pp. 40–41, 42):

> ART. 1581. *Need of inventories.*—In order to reflect the net income correctly, inventories at the beginning and end of each year are necessary in every case in which the production, purchase or sale of merchandise is an income-producing factor. The inventory should include raw materials and supplies on hand that have been acquired for sale, consumption or use in productive processes, together with all finished or partly finished goods. Only merchandise title to which is vested in the taxpayer should be included in the inventory. * * *
>
> ART. 1582. *Valuation of inventories.*—The Act provides two tests to which each inventory must conform—(1) It must conform as nearly as may be to the best accounting practice in the trade or business, and (2) it must clearly reflect the income. It follows, therefore, that inventory rules can not be uniform but must give effect to trade customs which come within the scope of the best accounting practice in the particular trade or business. In order to clearly reflect income, the inventory practice of a taxpayer should be consistent from year to year, and greater weight is to be given to consistency than to any particular method of inventorying or basis of valuation, so long as the method or basis used is substantially in accord with these regulations. An inventory that can be used under the best accounting practice in a balance sheet showing the financial position of the taxpayer can, as a gen-

eral rule, be regarded as clearly reflecting his income.

The basis of valuation most commonly used by business concerns and which meets the requirements of the Revenue Act is (*a*) cost or (*b*) cost or market, whichever is lower. (For inventories by dealers in securities, see art. 1585.) * * *

In respect to normal goods, whichever basis (*a*) or (*b*) is adopted must be applied with reasonable consistency to the entire inventory. Taxpayers were given an option to adopt the basis of either (*a*) cost or (*b*) cost or market, whichever is lower, for their 1920 inventories, and the basis adopted for that year is controlling and a change can now be made only after permission is secured from the Commissioner. * * *

* * * * *

ART. 1584. *Inventories at market.*—Under ordinary circumstances, and for normal goods in an inventory, "market" means the current bid price prevailing at the date of the inventory for the particular merchandise in the volume in which usually purchased by the taxpayer, and is applicable in the cases (*a*) of goods purchased and on hand, and (*b*) of basic elements of cost (materials, labor and burden) in goods in process of manufacture and in finished goods on hand; exclusive, however, of goods on hand or in process of manufacture for delivery upon firm sales contracts (i. e., those not legally subject to cancellation by either party) at fixed prices entered into before the date of the inventory, which goods must be inventoried at cost. Where no open market exists or where quotations are nominal due to stagnant market conditions, the taxpayer must use such evidence of a fair

market price at the date or dates nearest the inventory as may be available, such as specific purchases or sales by the taxpayer or others in reasonable volume and made in good faith, or compensation paid for cancellation of contracts for purchase commitments. Where the taxpayer in the regular course of business has offered for sale such merchandise at prices lower than the current price as above defined, the inventory may be valued at such prices less proper allowance for selling expense, and the correctness of such prices will be determined by reference to the actual sales of the taxpayer for a reasonable period before and after the date of the inventory. Prices which vary materially from the actual prices so ascertained will not be accepted as reflecting the market. It is recognized that in the latter part of 1918, by reason among other things of governmental control not having been relinquished, conditions were abnormal and in many commodities there was no such scale of trading as to establish a free market. In such a case, when a market was established during the succeeding year, a claim may be filed for any loss sustained in accordance with the provisions of section 214 (a) 12 or section 234 (a) 14 of the statute. See articles 261–268.

U. S. GOVERNMENT PRINTING OFFICE: 1921

tion of ammunition under the contracts and indicated the intention of the United States to take steps to settle its remaining liability under the contracts *College Point Boat Corp.* v. *United States,* 267 U. S. 12, relied upon by the petitioner, involved contracts which did not contain provisions such as those above set forth and does not seem relevant to the instant case.

It must be admitted that the question whether the goods come within the precise category mentioned in the regulations in which the court below placed them is not free from doubt, particularly as the amended regulations inserted after the words "firm sales contracts" the following:

> (i. e., those not legally subject to cancellation by either party).

But even if they do not come within that category, it would not seem to follow that the Commissioner's determination should be reversed. Article 1584 obviously was not intended to provide expressly for every situation, as is shown by the fact that it begins with the words "under ordinary circumstances," and that Article 1582 (pp. 20–21, *infra*) seems to contemplate that the Commissioner should be allowed some discretion and that the taxpayer should not be granted the absolute right to adopt the basis of "cost or market, whichever is lower," for inventories prior to the year 1920. It may well be that the regulations contain no express provision covering the unusual situation in the instant case.

If so, it was the duty of the Commissioner to determine the proper basis for determining the value of the inventory, and his decision in this case seems to be consistent with the general theory underlying the regulations. One of the fundamental tests for each inventory is that "it must clearly reflect the income" (Article 1582, p. 20, *infra*), and other provisions of the regulations seem to contemplate that goods can not be inventoried at a merely nominal value where the general market value is nominal if they are being manufactured for a solvent customer who is under obligations to pay a substantial price for them. An inventory fixing the value of goods at $231,000 would not clearly reflect the income where the goods actually cost over $700,000 and were disposed of for that figure or more.

The petitioner contends that "taxes must be determined according to what takes place in the tax year" and that the Commissioner was not warranted in adopting as the value of the materials in question the amounts paid by the United States to the petitioner as the cost thereof under the settlement contracts entered into in 1920, 1921, and 1922. The Commissioner's determination of the value of the materials, as of December 31, 1918, was not made until after the settlement contracts had been executed. The time for assessing the petitioner's taxes for 1918 had not then expired. (R. 59–60.) In determining, in 1925, the value as of

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No. 348

In the Supreme Court of the United States

OCTOBER TERM, 1931

UNITED STATES CARTRIDGE COMPANY, PETITIONER

v.

THE UNITED STATES

ON WRIT OF CERTIORARI TO THE COURT OF CLAIMS

BRIEF FOR THE UNITED STATES

INDEX

	Page
Opinion below	1
Jurisdiction	1
Questions presented	2
Statutes and Regulations	2
Statement:	
I. Facts bearing upon claim for obsolescence of buildings	3
II. Facts bearing upon valuation of inventory	6
Summary of Argument	9
Argument:	
I. In computing its taxable income for 1918, the petitioner was not entitled to a deduction in respect of the buildings erected by it upon leased land in excess of the deduction allowed by the Commissioner	12
II. In computing petitioner's taxable income for 1918 the Commissioner did not err in the valuation which he placed upon the portion of petitioner's inventory on hand at December 31, 1918, which consisted of material acquired for use in connection with its contracts with the United States	21
A. The statute and applicable regulations were designed to prevent deductions for losses through inventory valuations when a taxpayer was secured against such losses	21
B. The contracts in question secured the petitioner against loss on account of the cost of its inventory of raw materials and work in process within the meaning of the regulations	24
C. In determining the cost figures for petitioner's inventory as of December 31, 1918, subsequent events may be considered	30
Conclusion	33
Appendix	34–45

CITATIONS

Cases:	
Acme Coal Co. v. *United States*, 70 C. Cls. 696	33
Botany Mills v. *United States*, 278 U. S. 282	14
Burnet v. *Niagara Falls Brewing Co.*, 282 U. S. 648	14, 17, 18
College Point Boat Corporation v. *United States*, 267 U. S. 12	29
De Laval Steam Turbine Company v. *United States*, No. 6, October Term, 1931, decided November 23, 1931	30

Cases—Continued. Page

Dorris Motor Car Co. v. *United States*, 60 C. Cls. 68, affirmed 271 U. S. 96 29
Duffy v. *Central R. R. of New Jersey*, 268 U. S. 55, 64 13
Ford v. *United States*, 273 U. S. 593, 611 16
Gambrinus Brewery Co. v. *Anderson*, 282 U. S. 638 15
Inland Products Co. v. *Blair* (C. C. A. 4th) 31 F. (2d) 867 .. 33
McCreery v. *Commissioner*, 4 B. T. A. 967, 979–980 32
Manville Jenckes Co. v. *Commissioner*, 4 B. T. A. 765, 789, 791 16
Mutual Chemical Company of America v. *Commissioner*, 12 B. T. A. 578 23
National City Bank of Seattle v. *The United States*, 64 C. Cls. 236, certiorari denied, 276 U. S. 620 13
New York Life Insurance Co. v. *Edwards*, 271 U. S. 109, 116 .. 21
Producers Fuel Co. v. *Commissioner*, 1 B. T. A. 202 33
Savage Arms Corporation v. *United States*, 266 U. S. 217 29
United States v. *White Dental Co.*, 274 U. S. 398, 401 21

Statutes:

Revenue Act of 1918, c. 18, 40 Stat. 1057, 1060, 1077, 1078—
Sec. 203 34
Sec. 234 34
Act of March 2, 1919, c. 94, 40 Stat. 1272 7

Miscellaneous:

Treasury Regulations 45—
Art. 109 38
Art. 141 39
Art. 143 40
Art. 144 21
Art. 161 41
Art. 164 42
Art. 165 43
Art. 183 43
Art. 184 43
Art. 1581 36
Art. 1582 36
Art. 1584 37
House Report 767, 65th Cong., 2d Session, p. 10 16

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OPINION BELOW

The opinion of the Court of Claims (R. 88) is reported in 71 C. Cls. 575 and also in 48 F. (2d) 983.

JURISDICTION

The judgment of the Court of Claims was entered June 10, 1931. (R. 200). The petition for a writ of certiorari was filed September 3, 1931, and granted November 23, 1931. (R. 203.) The jurisdiction of this Court rests upon Section 3 (b) of the Act of February 13, 1925.

QUESTIONS PRESENTED

1. Whether the petitioner, in computing its taxable income for the year 1918, was entitled to deduct, as for obsolescence, the depreciation in value of its interest in buildings, which it had erected on leased land for the purpose of manufacturing munitions of war, resulting from the termination of the business after the armistice. The facts relating to this question are stated on pp. 3–6, *infra*.

2. Whether, in computing petitioner's taxable income for the year 1918, the Commissioner erred in the valuation which he placed upon the petitioner's inventory as of December 31, 1918. This question depends upon the proper method of valuing certain material which was being manufactured for the Government. The facts relating to this question are stated on pp. 6–9, *infra*.

STATUTES AND REGULATIONS

The applicable statutes and regulations appear in the Appendix, pp. 34–45, *infra*.

STATEMENT

This suit was brought to recover alleged overpayments of the petitioner's 1918 income and profits taxes amounting to $843,589.12. The petitioner's claim was predicated upon three alleged errors of the Commissioner. (R. 15–43.) The Court of Claims sustained the contention of the petitioner as

to one of the alleged errors and entered judgment for petitioner for $160,978.83 and interest. (R. 200.) No question as to this point is here involved.

I. Facts bearing upon claim for obsolescence of buildings

Prior to 1914 the petitioner was engaged in the manufacture of ammunition for commercial purposes, its business being carried on principally in rented buildings. (R. 77.) In 1914, for the purpose of completing orders for munitions of war which it had received and expected to receive while the war continued, the petitioner began the construction of certain buildings on land of its lessor, under an agreement whereby it was to occupy such land and buildings, rent free, for ten years, at the end of which time the buildings were to become the property of the lessor. (R. 77–78.) These buildings were erected, largely in 1915 and 1916, at a cost to the petitioner of $802,499.49. (R. 78.)

When the petitioner erected the buildings it had no use for them except for war purposes. During the World War the petitioner conducted a large and profitable business in ammunition intended for use in the war, first for European Governments, and later for the United States after it entered the war, and it used the buildings during the war to their full capacity. After the armistice in 1918 the petitioner received no new orders for military ammunition and did not expect any. It had no expectation of continuing the production of mili-

tary ammunition after the war and did not do so to any material extent. (R. 78–79.)

During the remaining period of the lease, none of the buildings in question was abandoned, and most of the space in them was used in the manufacture of commercial ammunition. A small part of the space was used in the manufacture of radiators, radiator tubes, motors, paper boxes and other articles. The volume of this other business was small as compared to the petitioner's commercial ammunition business. Approximately nine-tenths of the petitioner's sales were of commercial ammunition in each of the years 1920 to 1924. The petitioner made no profit from any of its manufacturing operations in any of the years 1919 to 1924, inclusive. (R. 81, 82, 84.)

Mechanically there is no difference between the manufacture of military ammunition and the manufacture of commercial ammunition, but the same machinery will produce more military ammunition because there are fewer sizes and types of the former than of the latter. (R. 82.)

Included in the buildings in question was a garage costing $41,017.03. (R. 78.) The petitioner had erected the garage for storage and service of its trucks and automobiles used in its own business. It needed the garage only while conducting the war business. From 1919 to October, 1923, the building was operated as a public garage through a subsidiary company. An agency for the sale of auto-

mobiles was also conducted there. It was used in its entirety for these purposes. This garage business showed a loss and the petitioner realized no net return from the garage until October, 1923, when it was leased to others at a rental of $300 a month, the petitioner paying the taxes and insurance on the building. (R. 83.)

The value of the petitioner's right to use all these buildings erected by it on the leased land for the six years of its lease remaining after December 31, 1918, did not exceed $190,969.86. (R. 82.)

In petitioner's income and excess-profits taxes for the years 1914 through 1917, inclusive, the Commissioner allowed deductions totalling $197,107.74 on account of depreciation in petitioner's interest in the buildings. (R. 79.) In its return for the 1918 income and profits taxes the petitioner averred that the value on December 31, 1918, of its right to use the buildings for the remaining six years of its lease was only $190,969.86, and asserted that it was entitled to deduct from its gross income of 1918 the difference between the depreciated value of the buildings at the beginning of 1918 (i. e., the cost, less depreciation to December 31, 1917) and the residual value of the lease, $190,969.86, at the end of 1918. The deduction so claimed amounted to $414,421.89. (R. 79–80.) The Commissioner rejected the claim and allowed a deduction of $86,484.54 for depreciation of petitioner's interest in the buildings. The amount of the latter allowance,

as well as the prior allowances, was based upon a rate so calculated that at the expiration of the lease the cost of the buildings would be extinguished by equal annual installments.

II. Facts bearing upon valuation of inventory

During 1918 the petitioner was engaged in manufacturing ammunition under four contracts with the United States, known as contracts (1) P6489–1489Sa, (2) 12621–3124A, (3) P12289–3034A, and (4) GA–126. One of these contracts was made in 1917 and the others on various dates in 1918 prior to November 11, 1918. (R. 67–68.) Each of the contracts contained a provision for cancellation by the Government in the event of the end of the war, and provided that in the event of the termination of the contract the Government would reimburse the petitioner for the cost of worked and unworked materials then on hand and other expenses incurred in connection with its commitments under the contracts. (R. 126, 142, 154, 170.)

In December, 1918, the Government notified the petitioner to suspend production under these contracts, each notice stating that the request was made with a view of negotiating a supplemental contract providing for the cancellation, settlement, and adjustment of the existing contract in a manner which would permit of a more prompt settlement of payment than would be practicable under the existing contract. (R. 69.) Pursuant

to these notices the petitioner suspended production under the contracts. (R. 70.)

Negotiations for settlement under the contracts were begun early in 1919. In March and April, 1920, supplemental contracts were executed between the petitioner and the United States with reference to each of the original contracts, except contract P6489–1489Sa. These supplemental contracts each provided for a method of determining the amounts to be paid to the petitioner on account of suspension of production under the contracts. (R. 71, 174–184, 201.) Contract P6489–1489Sa, executed May 6, 1918, was supplemented by an agreement made December 18, 1918, which was not executed in compliance with the statutory requirements. The War Department treated the original contract, as so amended, as within the provisions of the Act of March 2, 1919, known as the Dent Act (c. 94, 40 Stat. 1272), and settled the contract and its amendment under procedure established to cover contracts not executed in accordance with statutory requirements. (R. 71, 132–134.)

In 1920 the United States took over the greater part of the petitioner's worked and unworked material under these contracts, and then paid petitioner the cost of all raw material, whether unworked or in the worked material, but nothing for the cost of labor and overhead expense incurred by the petitioner in connection with the worked materials. (R. 71.) In 1921 and 1922 final settlement of the

contracts was effected, by which the Government reimbursed the petitioner for the cost of labor and overhead on the material previously delivered to it, and for the cost of the remaining portions of its inventory or for a part of this cost less the salvage value of such portions, and in the latter case the petitioner retained the material for which it had been so reimbursed. (R. 75.)

The fair market value of the worked and unworked materials which the petitioner had on hand on December 31, 1918, applicable to the contracts here involved, without considering any special value arising from obligations of the United States, was $231,615.43. (R. 76.) The value of these materials on that date, pricing at cost those which were subsequently taken over at cost by the United States, pricing the materials for which the petitioner was paid a part of the cost at the amount which was received therefor under the settlement contracts, and pricing the remainder at the fair market value on December 31, 1918, was $732,088.62. (R. 76.) In valuing the petitioner's inventory at the end of 1918 for the purpose of determining the petitioner's 1918 taxes, the Commissioner valued the materials in question at $732,088.62 (R. 76) and rejected the petitioner's contention that they should have been valued at $231,615.43. (R. 77.) Any reduction in the inventory below $732,088.62 would cause an equal reduction in the petitioner's taxable income for 1918. (R. 77.) The petitioner kept its accounts and

made its returns for the calendar year upon the accrual basis. (R. 59.)

The Court of Claims held that the Commissioner did not err either in fixing the allowance for exhaustion of the leased buildings or in the valuation of the petitioner's inventory. (R. 96–110.)

SUMMARY OF ARGUMENT

In computing petitioner's income and profits tax for the years 1914 to 1924, inclusive, the Commissioner allowed a deduction in each of those years, in respect of petitioner's investment in the buildings on leased land, of an amount equal to the total cost of the buildings divided by the number of years of the lease. Under this method there was returned to the petitioner in equal annual installments the full cost of the buildings by the time the lease expired. This procedure, we contend, is in accord with the law and regulations.

The petitioner contends that since the buildings were constructed solely for war uses, which ended with the signing of the Armistice, and since they were not profitably employed during the remainder of the term, it is entitled to charge off in 1918 as obsolescence an amount representing the difference between the depreciated cost of the buildings as of January 1, 1918, and the value, as of December 31, 1918, of the right to use the buildings for the remainder of the term of the lease. It bases this right upon the general provision in Section 234 (a) (7) in the Revenue Act of 1918 for a deduc-

tion of "a reasonable allowance for obsolescence" and the construction of that language by this Court in *Burnet* v. *Niagara Falls Brewing Co.*, 282 U. S. 648. But it should be borne in mind that "obsolescence" was expressly mentioned in no Revenue Act prior to that of 1918, and to determine the scope of the word we must look at other provisions of that Act. Paragraph (8) of the same section permitted "a reasonable deduction for the amortization of such part of the cost" of buildings, etc., constructed on and after April 6, 1917, "for the production of articles contributing to the prosecution of the present war." The fact that Congress provided for such a deduction for amortization only of buildings and other facilities constructed on and after April 6, 1917, indicates clearly that it did not intend to allow such a deduction to taxpayers whose buildings were erected to furnish war supplies to the European nations before the United States entered the conflict. The legislative history of this provision indicates that Congress contemplated that no other provision of the Act allowed a deduction on account of loss of value of war factories due to the end of the war.

Even if the statute should be construed to extend to obsolescence of munition factories constructed prior to April 6, 1917, caused by the Armistice, we submit the facts here do not establish any basis for such obsolescence during 1918. The mere fact that the value of the petitioner's interest in the buildings declined suddenly at the end of 1918 does not

establish obsolescence. They were readily adaptable to petitioner's ammunition and other businesses, and were so used. The mere fact that these businesses turned out not to be profitable is not significant.

The Commissioner did not err in the valuation which he placed upon the petitioner's inventory as of December 31, 1918.

The statute and applicable regulations were designed to prevent deductions for losses through inventory valuations when the taxpayer was secured against such losses. The Commissioner promulgated a regulation pursuant to a statutory mandate in regard to inventories, and construed this as providing that in the instant case material for which the Government was compelled to pay the cost should be inventoried at cost, even though a taxpayer generally may take his inventory at cost or market, whichever is lower. Here the contracts of the taxpayer assured it that it would be reimbursed for the cost of material which was not completed at the time of the cancellation of the contracts. Even if this provision did not render the contracts "firm sales contracts" within the strict meaning of the regulations, it would be a distortion of income to value goods at $231,000 where they actually cost over $700,000 and the Government was obliged to pay for them at cost. If the provision in the regulations relating to "firm sales contracts" is not applicable, nevertheless it was the duty of

the Commissioner to require an inventory which would reflect true income.

The contention of the petitioner that the contracts guaranteed no reimbursement of the cost of materials after suspension notices had been sent in 1918 is not supported by the facts.

In determining the cost figures for petitioner's inventory as of December 31, 1918, it was proper for the Commissioner to consider the payments made by the Government, as they represented the ascertainment of the cost of the inventory.

ARGUMENT

I

IN COMPUTING ITS TAXABLE INCOME FOR 1918, THE PETITIONER WAS NOT ENTITLED TO A DEDUCTION IN RESPECT OF THE BUILDINGS ERECTED BY IT UPON LEASED LAND IN EXCESS OF THE DEDUCTION ALLOWED BY THE COMMISSIONER

The buildings in question were constructed by the petitioner on leased land during the years 1914, 1915, and 1916,[1] under an agreement providing that the petitioner should have the right to use the buildings for ten years from January 1, 1915, paying no rent to the lessor, and at the end of the ten years they should become the property of the lessor. The right of the petitioner to use the buildings, therefore, ended December 31, 1924.

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[1] Only $72.21 was spent on building construction during 1917. (R. 78.)

As has been stated, in computing petitioner's income and profits tax for the years 1914 to 1924, inclusive, the Commissioner allowed a deduction in each of those years, in respect of petitioner's investment in the buildings, of an amount equal to the total cost of the buildings divided by the number of years of the lease. Under this method there was returned to the petitioner in equal annual installments the full cost of the buildings by the time the lease expired. This procedure, we contend, is in accord with the law and regulations. Article 109, Reg. 45 (p. 38, *infra*); *National City Bank of Seattle* v. *The United States*, 64 C. Cls. 236; certiorari denied, 276 U. S. 620. See *Duffy* v. *Central R. R. of New Jersey*, 268 U. S. 55, 64.

The petitioner contends that the change of circumstances produced by the termination of the war in 1918 justifies a deduction in 1918 on account of its investment in the buildings on a wholly different basis. It contends that since the buildings were constructed solely for war uses, which ended with the signing of the Armistice, and since they were not profitably employed during the remainder of the term of the lease it is entitled to charge off in 1918 as obsolescence an amount representing the difference between the depreciated cost of the buildings as of January 1, 1918, and the value as of December 31, 1918, of the right to use the buildings for the remainder of the term of the lease. If petitioner's contention is sound it is entitled to a deduction of $414,421.89 from its gross income for

1918 instead of $86,484.54, the amount allowed by the Commissioner of Internal Revenue.

We concede that there was an unusual decline in the value of the buildings during 1918, and do not dispute the finding of the Court of Claims that the value of the petitioner's right to use them during the remaining six years of the lease was $190,969.86. (R. 82.) But we contend that the method of allowing the deductions adopted by the Commissioner is correct and that the petitioner is not entitled to a greater deduction on account of obsolescence. As it is well settled that a taxpayer has a right to take only such deductions as are expressly allowed by the statute, the question is simply what statutory provision is applicable to the situation. See *Botany Mills* v. *United States*, 278 U. S. 282. The petitioner relies upon Section 234(a) (7) of the Revenue Act of 1918, which provides:

> SEC. 234. (a) That in computing the net income of a corporation subject to the tax imposed by section 230 there shall be allowed as deductions:
>
> * * * * *
>
> (7) A reasonable allowance for the exhaustion, wear and tear of property used in the trade or business, including a reasonable allowance for obsolescence;

It argues that this provision for obsolescence is applicable and relies upon the decision of this Court in *Burnet* v. *Niagara Falls Brewing Co.*, 282 U. S. 648, which upheld deductions for 1918 and 1919 for obsolescence of brewery property caused by prohi-

bition legislation, although the taxpayer continued to use part of the property until 1921 in another enterprise. We submit that that decision is not controlling. If paragraph (7) (quoted above) alone were involved, it would indeed be arguable that Congress intended to provide for an allowance for obsolescence even in such a case as this. But it should be borne in mind that "obsolescence" was expressly mentioned in no Revenue Act prior to that of 1918,[2] and to determine the scope of the word we may look at other provisions of that Act.

Immediately after the provision for obsolescence in Section 234 is a provision permitting deductions:

> (8) In the case of buildings, machinery, equipment, or other facilities, constructed, erected, installed, or acquired, on or after April 6, 1917, for the production of articles contributing to the prosecution of the present war, * * * there shall be allowed a reasonable deduction for the amortization of such part of the cost of such facilities or vessels as has been borne by the taxpayer, but not again including any amount otherwise allowed under this title or previous Acts of Congress as a deduction in computing net income. * * *

The fact that Congress allowed for such a deduction for such "amortization" only in the case of buildings and other facilities constructed on or

[2] See *Gambrinus Brewery Co.* v. *Anderson*, 282 U. S. 638, 643–644.

after April 6, 1917, indicates clearly that it did not intend to allow such a deduction to taxpayers whose buildings were erected to furnish war supplies to the European nations before the United States entered the conflict. *Manville Jenckes Co.* v. *Commissioner,* 4 B. T. A. 765, 789–791. As this Court indicated in *Ford* v. *United States,* 273 U. S. 593, 611, the doctrine, *"Expressio unius est exclusio alterius"* applies "when in the natural association of ideas in the mind of the reader that which is expressed is so set over by way of strong contrast to that which is omitted that the contrast enforces the affirmative inference that that which is omitted must be intended to have opposite and contrary treatment."

The legislative history of Section 234 (a) (8) indicates, also, that Congress did not intend to allow a taxpayer situated like the petitioner to deduct a loss caused by the unexpected termination of the war and its war business. In proposing the new deduction for the Revenue Act of 1918, the Committee on Ways and Means reported (House Report 767, 65th Congress 2d Session, at page 10):

> (4) Due to the necessity for erecting buildings and building machinery for war purposes many buildings and much machinery have been erected that will be of little value after the war. Under existing law it is impossible for the Treasury Department to allow deductions other than for the ordinary exhaustion, wear and tear, and depletion of such property. A provision is in-

corporated in this bill to allow the Treasury Department in such cases to allow special amounts for amortization, according to the peculiar condition in each case, but such amounts can not exceed in any year 25 per cent of the net income.

The petitioner's reliance upon Section 234 (a) (4) and 234 (a) (7) of the Revenue Act of 1918, as interpreted by the applicable Regulations, as a basis for the allowance of the deductions claimed by it, is in effect an attempt to gain the benefits of Section 234 (a) (8) without meeting the requirements of that section. Section 234 (a) (8) defines the right which petitioner asserts and places limitations thereon which exclude the petitioner from its enjoyment.

Even if the statute should be construed to extend to obsolescence of munition factories constructed prior to April 6, 1917, caused by the Armistice, we submit that the facts here do not establish the basis for such obsolescence during 1918. For we conceive of obsolescence not as a mere decline in value, but as a condition by which property approaches the state of permanent uselessness.[1] Mere loss in value of physical assets because of a lack of available willing purchasers is not obsolescence. Thus depreciation in values, due to a panic or an economic deflation, does not constitute

[1] Cf. *Burnet* v. *Niagara Brewing Co.*, *supra*, 282 U. S. 648, 653–654.

obsolescence. The finding of the court as to the diminished value at the end of 1918 does not establish obsolescence.

We submit that the instant case does not present a situation parallel to that involved in the *Niagara Falls Brewing case, supra.* There it became apparent to the taxpayer in 1918 that, because of prohibition legislation, it would soon be required to abandon forever the use of its property for the purpose for which it was acquired. That property was designed and constructed for the brewing of beer and was not available or readily adaptable to other uses. After prohibition became effective, a portion of the property was abandoned and the remainder was used to a limited extent for a brief time in the manufacture of near beer.

It is true that when the petitioner erected the buildings it had no use for them except for war purposes. But the termination of the war did not prohibit the petitioner from using the buildings for the remainder of the term of the lease for the purpose for which they were constructed. The buildings which had been used for the production of war materials were readily adaptable, apparently at little or no expense, to the petitioner's commercial ammunition business. Although after the war the petitioner had more space, in its new and old buildings, than it needed for its commercial ammunition business, it continued to use the new buildings for the manufacture of new products. None of the buildings was discarded or abandoned. Al-

though the petitioner made no profit in its new businesses in the years immediately following the war, this fact would not seem to be of much significance since it was not apparent at the end of 1918 that it would not make profits in the future. In the short time between November 11, 1918, and the close of the year 1918, it was hardly in a position to predict this. While it was reasonable for it to expect that it would not enjoy the same degree of prosperity from its peace-time business as it did from its war business, it obviously had no way of knowing that it would not be able to employ the use of its buildings for the remainder of the term of the lease to its advantage. It is common knowledge that business generally in this country in the post-war period, except for a time in about 1921, was very prosperous. It is well known that many manufacturing companies which had engaged in the manufacture of munitions during the war were able to adapt their plants to other uses and prospered greatly in peace-time production. The petitioner's buildings were for the most part of brick and concrete construction and were readily adaptable to other uses, as evidenced by the fact that it manufactured such articles as radiators, motors, and paper boxes in addition to ammunition, in the post-war period. Of course the rental value of such properties was greatly depreciated and this is reflected in the value of petitioner's right to use them for the unexpired term of its lease. They were, however, as fit and quite as available for such

use as they ever were. The effect of prohibition upon brewing plants was different. Their property was peculiarly adaptable to a single line of manufacture, and the probability of converting the property to other profitable uses was extremely remote. The Court of Claims aptly distinguished the petitioner's situation from the situation of the brewers, when it said (R. 109):

> * * * It (the petitioner's case) is in all respects similar to a case wherein a business enterprise enjoying prosperity finds enlarged quarters essential to meet its demands, and without knowledge as to any exact date when an intervening incident may curtail its income, such as bad times, termination of a war, drought, etc., income is materially reduced or disappears, and the enlarged quarters are no longer essential for the needs of the corporation during this period of distress. Under these circumstances what may happen to the buildings during the remaining period of the lease is problematical and is distinctly different from a case where legislation prohibits the future use of the buildings for the purposes erected, and for which purpose they were specially designed and constructed and not "readily adaptable to other uses." * * *

Indeed, it would seem to be only a short step from the contention of the petitioner to the contention that obsolescence or loss for tax purposes is incurred in any case where there is a sudden drop in the demand for the productive use of property.

If in good times a taxpayer expands his plant, he should not be allowed a deduction for obsolescence when on account of some unforeseeable event, such as the present depression, he finds that his business does not require the use of his whole plant. The income tax laws do not provide that such fluctuating conditions give rise to deductible losses. Articles 143, 144 of Regulations 45 (p. 40, *infra*); *New York Life Insurance Co.* v. *Edwards*, 271 U. S. 109, 116. See also *United States* v. *White Dental Co.*, 274 U. S. 398, 401, where this Court stated:

> The statute obviously does not contemplate and the regulations (Art. 144) forbid the deduction of losses resulting from the mere fluctuation in value of property owned by the taxpayer.

II

IN COMPUTING PETITIONER'S TAXABLE INCOME FOR 1918 THE COMMISSIONER DID NOT ERR IN THE VALUATION WHICH HE PLACED UPON THE PORTION OF PETITIONER'S INVENTORY ON HAND AT DECEMBER 31, 1918, WHICH CONSISTED OF MATERIAL ACQUIRED FOR USE IN CONNECTION WITH ITS CONTRACTS WITH THE UNITED STATES

A. The statute and applicable regulations were designed to prevent deductions for losses through inventory valuations when a taxpayer was secured against such losses

Section 203 of the Revenue Act of 1918 (p. 34, *infra*), provides two tests for every inventory, (1) it must conform as nearly as may be to the best

accounting practice applicable to the trade or business involved, and (2) it must clearly reflect the income. Furthermore, this section delegates to the Commissioner of Internal Revenue the duty and power to make such regulations relating to the basis upon which inventories shall be valued, as, in his opinion, conform to these two tests. It is established that regulations promulgated pursuant to such a statutory mandate have the force of law and are as binding upon the courts as if incorporated in the statute itself.

Articles 1581 to 1584, inclusive, of Regulations 45, as amended by Treasury Decision 3296, C. B. I–1, p. 40 (pp. 36–38, *infra*), recognize two general methods of valuing inventories: (1) Cost, and (2) cost or market, whichever is lower. An inventory taken under method (1) on the basis of the cost price of merchandise has the effect of deferring any gain or loss on such merchandise until it is actually disposed of. Where method (2) is adopted, and market value is lower than cost, the effect is to bring into the account a loss which may never be realized.

Article 1584 (*infra,* p. 37), recognizes the necessity for an exception to the general method (2), that merchandise be inventoried at cost or market, whichever is lower, for it provides:

> * * * Goods on hand or in process of manufacture for delivery upon firm sales contracts (i. e., those not legally subject to

> cancellation by either party) at fixed prices entered into before the date of the inventory * * * must be inventoried at cost.

The purpose and intent of this regulation was considered by the United States Board of Tax Appeals in *Mutual Chemical Company of America* v. *Commissioner,* 12 B. T. A. 578. The Board, holding that the inventory composed of raw materials was for delivery on a firm sales contract and should be valued at cost, said:

> The purpose of the regulations promulgated under that section of the Act of allowing taxpayers to compute inventories on the basis of cost or market, whichever is lower, as distinguished from the cost basis, is to allow an accounting for any reduction in the value of the inventory which has in fact taken place during a taxable year, thereby more clearly reflecting income. Where the inventories on hand, whether in the form of raw materials, goods in process, or finished goods, are required to fulfill legally enforceable contracts, it is obvious that the taxpayer is protected against any reduction in value occasioned by declining market prices; and to allow a taxpayer where he is protected by sales contracts at a price in excess of cost or market, to inventory those items at market, would distort his income in that he would show a loss in one year when in fact none was sustained and a greater gain than the true gain in the following year when the sales were executed.

It appears from this decision that the object of the Treasury in promulgating this regulation was to avoid an inaccurate reflection of income through improper inventory deductions. It seems evident that where a taxpayer has legally enforcible assurance that he will be paid the cost of his inventory, then such inventory must be taken at cost rather than at a figure which must reflect a loss which he has not and can not suffer. To apply a market price lower than cost in such a case distorts the actual income and defeats the general purpose of the statute.

B. The contracts in question secured the petitioner against loss on account of the cost of its inventory of raw materials and work in process, within the meaning of the regulations

On December 31, 1918, the petitioner had on hand a large quantity of raw materials and work in process intended for use under its four contracts with the United States. These contracts had been suspended after the Armistice, and on December 31, 1918, the general market value of the materials was $231,615.43. But the contracts provided for the petitioner's reimbursement for the cost of the materials.

There were four such contracts, known as (1) P12621–3124A, (2) P6489–1489Sa, (3) P12289–3034A, and (4) GA–126. Contract P12621–3124A contained the following provision (R. 163, 170):

ARTICLE XIV. *Termination.*—This contract being necessitated by a state of war now existing, it is desirable and expedient that provision be made for its cancellation upon fair and equitable terms in the event of the termination or limitation of the war, or if in anticipation thereof or because of changes in methods of warfare the Chief of Ordnance should be of the opinion that the completion of this contract has become unnecessary. It is therefore provided that at any time and from time to time, during the currency of this contract, the Chief of Ordnance may for any of the causes above stated notify the Contractor that any part or parts of the articles then remaining undelivered shall not be manufactured or delivered.

In the event of such complete or partial termination the United States shall inspect all completed articles then on hand and such as may be completed within thirty (30) days after such notice and shall pay to the Contractor the price herein fixed for all articles accepted by and delivered to the United States. The United States shall also pay to the contractor the cost of the materials and component parts purchased by the contractor for the performance of this contract and then on hand in an amount not exceeding the requirements for the completion of this contract provided they comply with the specifications, and also all costs shown by the contractor to have been theretofore necessarily incurred in the performance of this contract and remaining unpaid;

> and the United States shall also protect the Contractor on all obligations incurred necessarily and solely for the performance of this contract of which the Contractor can not be otherwise relieved. To the above may be added such sums as the Chief of Ordnance may deem necessary to fairly and justly compensate the Contractor for work, labor and service rendered under this contract.

The three other contracts each contained a similar provision, except that contract GA–126 did not give petitioner the right to continue production for thirty days after notice of termination. (R. 153, 141, 125.) Although the contracts were not formally canceled, work under them was suspended upon demand by the United States, and, we submit was "terminated" within the meaning of that word as used in the contracts.

The petitioner contends that these contracts were not "firm sales contracts," within the meaning of Article 1584—i. e., "those not legally subject to cancellation"—and that therefore that Article does not require the inventory to be valued at cost. A strict, literal reading of the regulation lends some support to this position. Although these contracts were subject to cancellation or termination, the contractor was guaranteed full reimbursement for the cost of raw materials and work in process in that event. Consequently the contractor was firmly assured by contract that cancellation would not inflict on it a loss in respect of the materials on hand. Evidently the purpose of the regulation

was to prevent the deduction of "inventory losses" if because of contractual obligations such losses could not become actual. The clause permitting cancellation or termination of these contracts did not take them out of the class of "firm sales contracts" for it was coupled with an assurance of payment of the cost of the materials. The effect of the contracts was to establish (1) a fixed price if the goods were completed and (2) repayment of the cost if the work was not completed. This was a firm contractual obligation to buy the finished product or upon cancellation to pay the cost of materials.

The petitioner's situation is precisely analogous to the situation covered by the regulation, and the Commissioner's valuation of the inventory should not be revised. His interpretation of the regulation which he promulgated is entitled to great weight. Evidently he believed that the contracts in this case were "firm-sales contracts," in spite of the cancellation clause, when he valued the inventories at cost. Such a ruling, in conformity with the intent of the statute and regulation, should not be upset even if inconsistent with the narrow definition used in the regulation. Article 1584 obviously was not intended to provide expressly for every situation, as is shown by the fact that it begins with the words "under ordinary circumstances," and that Article 1582 (p. 36, *infra*) seems to contemplate that the Commissioner should be allowed some discretion and that the tax-

payer should not be granted the absolute right to adopt the basis of "cost or market, whichever is lower," for inventories prior to the year 1920. It may well be that the regulations contain no express provision covering the unusual situation in the instant case. If so, it was the duty of the Commissioner to determine the proper basis for determining the value of the inventory, and his decision in this case seems to be consistent with the general theory underlying the regulations. One of the fundamental tests for each inventory is that "it must clearly reflect the income" (Article 1582, p. 36, *infra*), and other provisions of the regulations seem to contemplate that goods can not be inventoried at a nominal value merely because the general market value is nominal, if they are being manufactured for a solvent customer who is under obligations to pay a substantial price for them. An inventory fixing the value of goods at $231,000 would not clearly reflect the income where the goods actually cost over $700,000, and the Government was under obligation to pay for them at cost.

The petitioner further contends that, whether the contracts were "firm-sales contracts" or not when executed, they guaranteed no reimbursement of the cost of materials after the suspension notices had been sent in December, 1918. It argues that work was not terminated in pursuance of the termination clauses of the contracts. The facts of the case do not support such position.

The contracts provided that the Chief of Ordnance might notify the contractor that any articles then undelivered should not be manufactured or delivered. This is just what the Chief of Ordnance did. His cause for the suspension notice was "the termination of the war," one of the causes mentioned in the contract. The petitioner did not insist upon its rights under the provision allowing manufacture for thirty days after the notice. By not so insisting it waived its rights to profits which it would have made by completing some more of the articles. *Savage Arms Corporation* v. *United States,* 266 U. S. 217; *Dorris Motor Car Co.* v. *United States,* 60 C. Cls. 68, affirmed 271 U. S. 96. But it did not thereby lose its right under the contracts to recover the cost of materials on hand. That right was guaranteed by the very clauses of the contracts under which the Chief of Ordnance acted in terminating the work. The suspension notices did refer to supplemental contracts to be negotiated. These were to amplify the rather brief provisions of the original contracts as to the payments of the cost of materials which of course remained in force unless and until varied by such supplemental contracts.

The petitioner attempts to show that the situation in this case after the receipt of the suspension notices was like that in *College Point Boat Corporation* v. *United States,* 267 U. S. 12. There the contract contained no cancellation clause, as do all the contracts in the instant case. The Navy De-

partment, unaware of its right to cancel the contract under the Act of June 15, 1917, requested the contractor to stop work. This Court held that in a suit for damages for the breach of the contract, the damages recoverable were limited by the existence of the right of cancellation, and that anticipated profits were not recoverable any more than in a suit for just compensation for loss because of cancellation. Of course the plaintiff's right to recover the cost of materials was not questioned, and the plaintiff in fact was paid such costs. The case is not in point, for in it operations were not ordered suspended pursuant to a termination clause in the contract; but it indicates that even if the present contracts had not specifically provided for the recovery of costs upon termination, the taxpayer would undoubtedly have been certain to recover either as just compensation, or as damages for a breach, the costs of the worked and unworked materials. See also *De Laval Steam Turbine Company* v. *United States,* No. 6, October Term, 1931, decided November 23, 1931. The petitioner was always assured of receiving the cost of the material, and therefore it would result in a misstatement of 1918 income to value the materials as of December 31, 1918, at less than cost.

C. In determining the cost figures for petitioner's inventory as of December 31, 1918, subsequent events may be considered

The petitioner urges that the respondent should not be permitted to consider events which occurred

after December 31, 1918, and value its inventory on the basis of payments received therefor in 1920, 1921, and 1922. The Government contends that this is permissible. The regulations require an inventory of this nature to be priced at cost. The payments received in the later years represent the *ascertainment of the cost* of this inventory. The record discloses only one specific instance in which the petitioner was not reimbursed for actual cost (Finding 34, R. 72–73), and in that case the goods were included in the inventory at the amount received therefor (Finding 41, R. 76–77.)

The petitioner filed its return for 1918 upon the accrual basis. (R. 59.) If on December 31, 1918, the petitioner had been unable to determine the exact cost of the inventory, it would have been permitted in its original return for 1918 to take the estimated cost of the inventory, and later, when the cost had been definitely ascertained, to file an amended return. Clearly, an inability to determine the accurate cost at December 31, 1918, does not create the right to inventory the merchandise on some other basis.

In the instant case the Commissioner's determination of the value of the materials, as of December 31, 1918, was not made until after the settlement contracts had been executed. The time for assessing the petitioner's taxes for 1918 had not then expired. (R. 59–60.) In determining, in 1925, the value as of December 31, 1918, of the materials, the Commissioner was not warranted in ignoring in-

tervening events having a legitimate bearing upon the value of the materials. The payment of the sums in question to the petitioner by the United States as the cost of the materials was the best evidence of such value available to the Commissioner. The Court below said (R. 98):

> It is of course true that at the close of the year 1918 the plaintiff was unaware as to the precise sum it would receive in dollars and cents for the materials on hand, the ascertainment of the same was yet to be made and the final result dependent upon accounting. It did, however, possess an enforceable demand for their cost in the form of a positive covenant to pay the same from a responsible party, and having voluntarily waived its right to have its tax liability for the year 1918 determined within the period of the statute of limitations with respect thereto, thereby enabled the exact determination of the cost of its inventory free from any uncertainty. The fixed statutory period within which the commissioner must determine a taxpayer's liability is a period which Congress extended to him to ascertain liability, and the ascertainment of the same is to be accomplished from the taxpayer's return.

In similar cases subsequent events are considered in ascertaining the true amount of a taxable gain from a sale at a tardily determined purchase price (*McCreery* v. *Commissioner*, 4 B. T. A. 967, 979–980) and in ascertaining the true amount of a deduction for a business loss through an admitted lia-

bility to pay unliquidated damages for breach of contract (*Producers Fuel Co.* v. *Commissioner*, 1 B. T. A. 202). See also *Inland Products Co.* v. *Blair* (C. C. A. 4th), 31 F. (2d) 867; *Acme Coal Co.* v. *United States*, 70 C. Cls. 696.

CONCLUSION

The decision of the Court of Claims is correct and should be affirmed.

Respectfully submitted.

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JANUARY, 1932.

APPENDIX

STATUTES AND REGULATIONS

The Revenue Act of 1918, c. 18, 40 Stat. 1057, 1060, 1077, 1078, provides in part:

> SEC. 203. That whenever in the opinion of the Commissioner the use of inventories is necessary in order clearly to determine the income of any taxpayer, inventories shall be taken by such taxpayer upon such basis as the Commissioner, with the approval of the Secretary, may prescribe as conforming as nearly as may be to the best accounting practice in the trade or business and as most clearly reflecting the income.
>
> * * * * *
>
> SEC. 234. (a) That in computing the net income of a corporation subject to tax imposed by section 230 there shall be allowed as deductions:
>
> (1) All the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, including a reasonable allowance for salaries or other compensation for personal services actually rendered, and including rentals or other payments required to be made as a condition to the continued use or possession of property to which the corporation has not taken or is not taking title, or in which it has no equity;
>
> * * * * *

(4) Losses sustained during the taxable year and not compensated for by insurance or otherwise;

* * * * *

(7) A reasonable allowance for the exhaustion, wear and tear of property used in the trade or business, including a reasonable allowance for obsolescence;

(8) In the case of buildings, machinery, equipment, or other facilities, constructed, erected, installed, or acquired, on or after April 6, 1917, for the production of articles contributing to the prosecution of the present war, and in the case of vessels constructed or acquired on or after such date for the transportation of articles or men contributing to the prosecution of the present war, there shall be allowed a reasonable deduction for the amortization of such part of the cost of such facilities or vessels as has been borne by the taxpayer, but not again including any amount otherwise allowed under this title or previous Acts of Congress as a deduction in computing net income. At any time within three years after the termination of the present war the Commissioner may, and at the request of the taxpayer shall, reexamine the return, and if he then finds as a result of an appraisal or from other evidence that the deduction originally allowed was incorrect, the taxes imposed by this title and by Title III for the year or years affected shall be redetermined and the amount of tax due upon such redetermination, if any, shall be paid upon notice and demand by the collector, or the amount of tax overpaid, if any, shall be credited or refunded to the taxpayer in accordance with the provisions of section 252;

* * * * *

Articles 1581, 1582, and 1584 of Treasury Regulations 45, as amended March 3, 1922 (C. B. I–1, pp. 40–41, 42), promulgated under Section 203 of the Revenue Act of 1918, provide as follows:

> ART. 1581. *Need of inventories.*—In order to reflect the net income correctly, inventories at the beginning and end of each year are necessary in every case in which the production, purchase or sale of merchandise is an income-producing factor. The inventory should include raw materials and supplies on hand that have been acquired for sale, consumption or use in productive processes, together with all finished or partly finished goods. Only merchandise title to which is vested in the taxpayer should be included in the inventory. * * *
>
> ART. 1582. *Valuation of inventories.*—The Act provides two tests to which each inventory must conform—(1) It must conform as nearly as may be to the best accounting practice in the trade or business, and (2) it must clearly reflect the income. It follows, therefore, that inventory rules can not be uniform but must give effect to trade customs which come within the scope of the best accounting practice in the particular trade or business. In order to clearly reflect income, the inventory practice of a taxpayer should be consistent from year to year, and greater weight is to be given to consistency than to any particular method of inventorying or basis of valuation, so long as the method or basis used is substantially in accord with these regulations. An inventory that can be used under the best accounting practice in a balance sheet showing the financial position of the taxpayer can, as a general rule, be regarded as clearly reflecting his income.

The basis of valuation most commonly used by business concerns and which meets the requirements of the Revenue Act is (a) cost or (b) cost or market, whichever is lower. (For inventories by dealers in securities, see art. 1585.) * * *

In respect to normal goods, whichever basis (a) or (b) is adopted must be applied with reasonable consistency to the entire inventory. Taxpayers were given an option to adopt the basis of either (a) cost or (b) cost or market, whichever is lower, for their 1920 inventories, and the basis adopted for that year is controlling and a change can now be made only after permission is secured from the Commissioner. * * *

* * * * *

ART. 1584. *Inventories at market.*—Under ordinary circumstances, and for normal goods in an inventory, "market" means the current bid price prevailing at the date of the inventory for the particular merchandise in the volume in which usually purchased by the taxpayer, and is applicable in the cases (a) of goods purchased and on hand, and (b) of basic elements of cost (materials, labor and burden) in goods in process of manufacture and in finished goods on hand; exclusive, however, of goods on hand or in process of manufacture for delivery upon firm sales contracts (i. e., those not legally subject to cancellation by either party) at fixed prices entered into before the date of the inventory, which goods must be inventoried at cost. Where no open market exists or where quotations are nominal due to stagnant market conditions, the taxpayer must use such evidence of a fair market price at the date or dates nearest the inventory as may be available, such as specific purchases or sales by

the taxpayer or others in reasonable volume and made in good faith, or compensation paid for cancellation of contracts for purchase commitments. Where the taxpayer in the regular course of business has offered for sale such merchandise at prices lower than the current price as above defined, the inventory may be valued at such prices less proper allowance for selling expense, and the correctness of such prices will be determined by reference to the actual sales of the taxpayer for a reasonable period before and after the date of the inventory. Prices which vary materially from the actual prices so ascertained will not be accepted as reflecting the market. It is recognized that in the latter part of 1918, by reason among other things of governmental control not having been relinquished, conditions were abnormal and in many commodities there was no such scale of trading as to establish a free market. In such a case, when a market was established during the succeeding year, a claim may be filed for any loss sustained in accordance with the provisions of section 214 (a) 12 or section 234 (a) 14 of the statute. See articles 261–268.

Article 109 of Treasury Regulations 45, promulgated under Section 234 (a) (1) of the Revenue Act of 1918, provides as follows:

ART. 109. *Rentals.*—Where a leasehold is acquired for business purposes for a specified sum, the purchaser may take as a deduction in his return an aliquot part of such sum each year, based on the number of years the lease has to run. Taxes paid by a tenant to or for a landlord for business property are additional rent and constitute a deductible item to the tenant and taxable income to the landlord, the amount of the tax being de-

ductible by the latter. The cost borne by a lessee in erecting buildings or making permanent improvements on ground of which he is lessee is held to be a capital investment and not deductible as a business expense. In order to return to such taxpayer his investment of capital, an annual deduction may be made from gross income of an amount equal to the total cost of such improvements divided by the number of years remaining of the term of lease, and such deduction shall be in lieu of a deduction for depreciation. If the remainder of the term of lease is greater than the probable life of the buildings erected, or of the improvement made, this deduction shall take the form of an allowance for depreciation.

Articles 141 and 143 of Treasury Regulations 45, promulgated under Section 234 (a) (4) of the Revenue Act of 1918, provide as follows:

ART. 141. *Losses.*—Losses sustained during the taxable year and not compensated for by insurance or otherwise are fully deductible (except by nonresident aliens) if (a) incurred in the taxpayer's trade or business, or (b) incurred in any transaction entered into for profit, or (c) arising from fires, storms, shipwreck or other casualty, or from theft. They must usually be evidenced by closed and completed transactions. In the case of the sale of assets the loss will be the difference between the cost thereof, less depreciation sustained since acquisition, or the fair market value as of March 1, 1913, if acquired before that date, less depreciation since sustained, and the price at which they were disposed of. See section 202 of the statute and articles 39–46 and 1561. When the loss is claimed through the destruction of property by fire, flood,

or other casualty, the amount deductible will be the difference between the cost of the property or its fair market value as of March 1, 1913, if acquired before that date, and the salvage value thereof, after deducting from such cost or such value as of March 1, 1913, the amount, if any, which has been or should have been set aside and deducted in the current year and previous years from gross income on account of depreciation and which has not been paid out in making good the depreciation sustained. But the loss should be reduced by the amount of any insurance or other compensation received. See articles 49 and 50. A loss in the sale of residential property is not deductible unless the property was purchased or constructed by the taxpayer with a view to its subsequent sale for pecuniary profit. Losses in illegal transactions are not deductible. Where a person gives away property, or is divested thereof by death, no realization of loss results therefrom.

ART. 143. *Loss of useful value.*—When through some change in business conditions the usefulness in the business of some or all of the capital assets is suddenly terminated, so that the taxpayer discontinues the business or discards such assets permanently from use in the business, he may claim as a loss for the year in which he takes such action the difference between the cost or the fair market value as of March 1, 1913, of any asset so discarded (less any depreciation sustained) and its salvage value remaining. This exception to the rule requiring a sale or other disposition of property in order to establish a loss requires proof of some unforeseen cause by reason of which the property must be prematurely discarded, as, for example, where an increase in the cost

of or other change in the manufacture of any product makes it necessary to abandon such manufacture, to which special machinery is exclusively devoted, or where new legislation directly or indirectly makes the continued profitable use of the property impossible. This exception does not extend to a case where the useful life of property terminates solely as a result of those gradual processes for which depreciation allowances are authorized. It does not apply to inventories or to other than capital assets. The exception applies to buildings only when they are permanently abandoned or permanently devoted to a radically different use, and to machinery only when its use as such is permanently abandoned. Any loss to be deductible under this exception must be charged off on the books and fully explained in returns of income. But see articles 181–189.

Articles 161, 164, and 165 of Treasury Regulations 45, promulgated under Section 234 (a) (7) of the Revenue Act of 1918, provide as follows:

ART. 161. *Depreciation.*—A reasonable allowance for the exhaustion, wear and tear and obsolescence of property used in the trade or business may be deducted from gross income. For convenience such an allowance will usually be referred to as depreciation, excluding from the term any idea of a mere reduction in market value not resulting from exhaustion, wear and tear or obsolescence. The proper allowance for such depreciation of any property used in the trade or business is that amount which should be set aside for the taxable year in accordance with a consistent plan by which the aggregate of such amounts for the useful life of the property in the business will

suffice, with the salvage value, at the end of such useful life to provide in place of the property its cost, or its value as of March 1, 1913, if acquired by the taxpayer before that date.

ART. 164. *Capital sum recoverable through depreciation allowances.*—The capital sum to be replaced by depreciation allowances is the cost of the property in respect of which the allowance is made, except that in the case of property acquired by the taxpayer prior to March 1, 1913, the capital sum to be replaced is the fair market value of the property as of that date. In the absence of proof to the contrary, it will be assumed that such value as of March 1, 1913, is the cost of the property less depreciation up to that date. To this sum should be added from time to time the cost of improvements, additions, and betterments, the cost of which is not deducted as an expense in the taxpayer's return, and from it should be deducted from time to time the amount of any definite loss or damage sustained by the property through casualty, as distinguished from the gradual exhaustion of its utility which is the basis of the depreciation allowance. In the case of the acquisition on or after March 1, 1913, of a combination of depreciable and nondepreciable property for a lump price, as, for example, land and buildings, the capital sum to be replaced is limited to that part of the lump price which represents the value of the depreciable property at the time of such acquisition. Where the lessee of real property erects buildings, or makes permanent improvements which become part of the realty and income or loss has been returned by the lessor as a result thereof, as provided in article 48, the capital sum to be replaced by depreciation allowances is held

to be the same as though no such buildings had been erected or such improvements made.

ART. 165. *Method of computing depreciation allowance.*—The capital sum to be replaced should be charged off over the useful life of the property either in equal annual installments or in accordance with any other recognized trade practice, such as an apportionment of the capital sum over units of production. Whatever plan or method of apportionment is adopted must be reasonable and should be described in the return.

Articles 183 and 184 of Treasury Regulations 45, promulgated under Section 234 (a) (8) of the Revenue Act of 1918, provide as follows:

ART. 183. *Property cost of which may be amortized.*—The taxpayer may deduct from gross income a reasonable allowance for amortization; such deduction not to be in excess of the cost of buildings, machinery, equipment or other facilities constructed, erected, installed, or acquired on or after April 6, 1917, for the production of articles contributing to the prosecution of the present war, or of vessels constructed or acquired on or after such date for the transportation of articles or men contributing to the prosecution of the present war.

In the case of property the construction, erection, installation, or acquisition of which was commenced before April 6, 1917, and completed subsequent to that date, amortization will be allowed with respect only to that part of the cost incurred on or after April 6, 1917, and which was properly entered on the books of the taxpayer on or after that date.

ART. 184. *Cost which may be amortized.*—The total amount subject to amortization shall be the difference between the original

cost of the property if constructed, erected, installed, or acquired on or after April 6, 1917; or if acquired partly before and partly after April 6, 1917, then that part of the cost incurred on or after April 6, 1917, and properly entered on the books of the taxpayer on or after that date, less any amounts deducted for depreciation, losses, etc., prior to January 1, 1918, and the value of the property on either of the bases indicated below:

(1) In the case of property useful to the taxpayer only during the period of its operation as a war facility and which has been sold or permanently discarded, or which will be sold or permanently discarded within three years after the termination of the war; the value shall be the actual sale price or estimated fair market value as of the date when the property was or will be permanently discarded, such fair market value to be reestablished at and as of the time of the investigation by engineers of the Bureau of Internal Revenue.

(2) In the case of property not included in (1) above, the value shall be the estimated value to the taxpayer in terms of its actual use or employment in his going business; such value to be not less than the sale or salvage value of the property: *Provided however,* That for the purposes of returns made in 1919, the preliminary estimate of the amount of such amortization shall not, in any case, have exceeded 25 per cent of the cost of the property. In the determination, by engineers of the Bureau of Internal Revenue, of the proper amortization allowance, the estimated value to the taxpayer of the property in terms of its actual use or employment in his going business, shall be as of the time of such determination. In the final determination, the amount of the

amortization allowance will be ascertained upon the basis of stable post-war conditions under regulations to be promulgated when these conditions become apparent.

Special record of all property falling in (1) above, must be preserved by the taxpayer, and the Commissioner must be promptly notified (a) if, after having been in good faith permanently discarded or dismantled, property shall in any case be restored to use because of conditions not foreseen or anticipated at the time it was discarded; or (b) of the selling price, if sold.

U. S. GOVERNMENT PRINTING OFFICE: 1933

SUPREME COURT OF THE UNITED STATES.

No. 348.—October Term, 1931.

United States Cartridge Company, Petitioner, *vs.* The United States. } On Writ of Certiorari to the Court of Claims.

[February 15, 1932.]

Mr. Justice Butler delivered the opinion of the Court.

Petitioner sued to recover an alleged overpayment of income and profits taxes for 1918. The court made findings of fact, ruled in favor of petitioner as to a part of the amount and gave it judgment for $160,978.83 which is not here challenged. The court dismissed petitioner's complaint as to two other claims which this writ, 284 U. S. —, brings up for consideration. One is on account of buildings erected by it for war purposes on leased land. The other involves the valuation of petitioner's inventories relating to government contracts. There is printed in the margin a statement showing the net income and taxes as determined by the Commissioner, the reduction made by the judgment and the deductions claimed by petitioner and denied by the court.[1]

The substance of the findings as to the buildings may be stated as follows:

Petitioner, for some years before the war, had been a manufacturer of ammunition for small arms used in times of peace. It carried on at Lowell, Massachusetts, principally in buildings rented from a power company. During the years 1911 to 1914 inclusive its business was relatively small and not profitable. In 1914 it

[1]Net income	$1,792,432.58	Taxes	$1,152,123.53
Reduction by court	195,362.67	Taxes	160,978.83
Leaving income	1,597,069.91	Taxes	991,144.70
Deduction claimed on account of buildings	327,937.35	Taxes	270,220.38
Deduction on account of inventories	500,473.19	Taxes	412,389.91

commenced making ammunition for use in the war and, for the purpose of continuing that business while the war should last, it constructed new buildings upon the power company's land at a cost of $802,499.49 pursuant to an agreement that it should have the right to use them rent free until December 31, 1924, and then hand them over to the power company. Until the armistice, at first for foreign governments and later for our own, it had orders, and used all the buildings, up to their capacity in the manufacture of war ammunition. There was no way of knowing when this demand would cease.

Petitioner did not expect to make military ammunition after conflict ended and in fact received no orders after the armistice. It continued the commercial ammunition business but made no profit in any year from 1918 to the end of the lease. The buildings could not be rented. Those belonging to the power company had been incorporated into the new ones. The space so made was much greater than required for its commercial ammunition business. Petitioner, for the purpose of utilizing the excess, undertook the manufacture of some other things, but that business wa small and resulted in loss each year. There was a garage used during the war production but not needed afterwards. Petitioner attempted to operate the building as a public garage but, realizing no net return, rented it to others from October, 1923, until the end of the lease.

The Commissioner allowed deductions on account of the cost of the buildings for the years from 1914 to 1917 inclusive amounting in all to $197,107.74, leaving as of the end of 1917, cost less depreciation $605,391.75. In the settlement of its 1918 taxes petitioner claimed that, as of the end of that year, the value of its right to use the new buildings during the remainder of the term was $190,969.86, and the Court of Claims found it not in excess of that amount. Petitioner claimed a deduction of the difference between the depreciated cost and such residual value. The Commissioner disallowed the claim on the ground that it had not abandoned the use of the buildings or permanently devoted them to a radically different use. He allowed $86,484.54, arrived at by distributing the cost of each building ratably over the period ending with the term of the lease. The difference between the deduction claimed and that allowed is $327,937.35. In its tax re-

turns for the remaining years of the lease, petitioner claimed deductions on account of the buildings amounting in all to $190,969.86, but the Commissioner added to such deductions $327,937.35.

The Revenue Act of 1918, 40 Stat. 1077, controls and its pertinent provisions are printed in the margin.[2] The Government maintains that subsection (8) excludes the allowance claimed. The contention is without merit. The argument is that, by authorizing amortization in respect of buildings erected for war production after April 6, 1917, Congress denied allowances for obsolescence as to like buildings constructed before the war. But obsolescence and amortization are not synonymous. While in some connections like meaning may be attributed to them, they do not necessarily or generally refer to the same thing. Obsolescence may arise from changes in the art, shifting of business centers, loss of trade, inadequacy, supersession, prohibitory laws and other things which, apart from physical deterioration, operate to cause plant elements or the plant as a whole to suffer diminution in value. *Burnet* v. *Niagara Brewing Co.*, 282 U. S. 646, 654. *Gambrinus Brew-*

[2]Sec. 234 (a). That in computing the net income of a corporation subject to the tax imposed by section 230 there shall be allowed as deductions:

. . . . . .

(7) A reasonable allowance for the exhaustion, wear and tear of property used in the trade or business, including a reasonable allowance for obsolescence;

(8) In the case of buildings . . . or other facilities, constructed . . . or acquired, on or after April 6, 1917, for the production of articles contributing to the prosecution of the present war, and in the case of vessels constructed or acquired on or after such date for the transportation of articles or men . . . there shall be allowed a reasonable deduction for the amortization of such part of the cost of such facilities or vessels as has been borne by the taxpayer, but not again including any amount otherwise allowed under this title or previous Acts of Congress as a deduction in computing net income. At any time within three years after the termination of the present war the Commissioner may, and at the request of the taxpayer shall, reexamine the return, and if he then finds as a result of an appraisal or from other evidence that the deduction originally allowed was incorrect, the taxes imposed by this title and by Title III [war-profits and excess-profits tax] for the year or years affected shall be redetermined and the amount of tax due upon such redetermination, if any, shall be paid upon notice and demand by the collector, or the amount of tax overpaid, if any, shall be credited or refunded to the taxpayer in accordance with the provisions of section 252;

ery Co. v. *Anderson,* 282 U. S. 638. Amortization as used in the Act is not so broad; it refers to deductions on account of such part of the costs of certain facilities as has been borne by the taxpayer, "but not again including any amount otherwise allowed". This safeguard against duplication of allowances on account of the same diminution in value shows that deductions for amortization were not intended to exclude obsolescence, but rather were to be made in addition or having regard to allowances deducted on account of obsolescence and the like.

The legislative history of the Act negatives the contention. In explanation of the deduction for amortization the Committee on Ways and Means, having charge of the measure, reported that many facilities provided for war purposes would be of little value after termination of the conflict; that, under the law then existing, it was impossible to allow deductions other than for the "ordinary exhaustion, wear and tear, and depletion of such property" and that the purpose was "to allow special amounts for amortization, according to the peculiar condition in each case . . ."[3] When that report was made, and as the draft of the Act was originally passed by the House and amended and passed in the Senate, it contained no provision expressly authorizing allowances for obsolescence. Subsection (7) in the form in which it was finally adopted was formulated in conference much later than the committee report, and after the provision for amortization as finally enacted had been agreed to. See *Gambrinus Brewery Co.* v. *Anderson, supra,* 643. Manifestly Congress intended by subsection (7) to establish a general rule and by subsection (8) to authorize, in a limited class of cases and under special circumstances, the amortization of certain costs by deductions not duplicating any other allowed by that or previous Acts of Congress.

Under the circumstances disclosed by the findings, the buildings erected by petitioner are not to be distinguished from equipment designed, constructed and suitable only for the performance of a single job or from brewery plants put out of use by prohibitory laws. The Government does not suggest that any part of the allowance claimed should have been deducted in petitioner's returns

[3] House Report 767, 65th Congress, 2d Session, p. 10. Senate Report 617, 65th Congress, 3d Session, p. 7.

for years prior to 1918. It was impossible to know when the conflict would cease but it was certain that, when demand for war materials ended, there necessarily would be great diminution in the value of the buildings. That remaining after the armistice, November 11, 1918, was properly to be regarded as in the nature of salvage. The depreciated cost less the value of petitioner's right to use the buildings after 1918 must be taken into account for the proper determination of petitioner's 1918 income and profits taxes. *Gambrinus Brewery Co.* v. *Anderson, supra. Burnet* v. *Niagara Brewing Co., supra.*

The findings as to inventories may be stated as follows:

At the end of 1918, petitioner had large quantities of material acquired for the production of war ammunition to be supplied by it under four contracts with the Government. The contracts provided that the Chief of Ordnance, upon termination or limitation of the war, might notify petitioner that any part of the articles then remaining undelivered should not be manufactured or delivered, and that: "In the event of such complete or partial termination [of performance of the contract] the United States shall inspect all completed articles then on hand and such as may be completed within thirty (30) days after such notice and shall pay to the Contractor the price herein fixed for all articles accepted . . . . The United States shall also pay to the contractor the cost of materials and component parts purchased by the contractor for the performance of this contract and then on hand . . ." together with other allowances mentioned.[4]

In December, 1918, the Chief of Ordnance caused letters to be sent petitioner in respect of each of its contracts stating: "You are requested in the public interest immediately to suspend further operations under your contract . . . and incur no further expenses in connection with the performance of said contract. This request is made with a view to the negotiation of a supplemental contract providing for the cancellation, settlement and adjustment of your existing contract, in a manner which will permit of a more prompt settlement and payment than will be practicable under the terms of said existing contract. Please acknowledge

[4]Each of the contracts contained a provision substantially the same as that quoted. One of them, GA-126, did not give petitioner a right to continue production for 30 days after termination.

receipt of this notice immediately, and indicate your decision as to compliance with or rejection of this request. Upon notice of your compliance, a representative of the Ordnance Department will forthwith take up with you the proposed negotiation."[5] Before the end of the year petitioner complied with these requests and ceased production under the contracts.

At the end of that year there was no market for the materials in the inventories; they were not saleable at any price approaching cost; it was wholly uncertain what amounts might be obtained in settlement, and no negotiations for adjustments or settlement had been made.

After negotiations involving much time and expense, partial settlements were reached in 1920 under which the Government took over and paid petitioner's cost for most of the raw material and work in process, except labor and overhead items chargeable to the latter. In final settlements in 1921 and 1922 there were compromises under which the Government paid a portion of the cost of some items and made no allowance for others.

Petitioner kept its books on the accrual basis and elected to price its inventories at cost or market whichever was lower. The difference between petitioner and the Commissioner as to 1918 taxes was whether inventories of material on hand at that date should be taken at $231,615.43, the then market value, or at $732,088.62 which was made up of amounts eventually realized by petitioner under the contracts of settlement. The latter was used by the Commissioner.

Mere inspection of the suspension requests disclose that they were not intended to be the notices provided for in the clauses authorizing the Government to terminate manufacture or deliveries. *College Point Boat Co.* v. *United States,* 267 U. S. 12, 15. And upon petitioner's compliance with such requests the contract provisions as to payments by the Government to petitioner of cost were superseded. At the end of 1918, the Government was not bound to take or to pay petitioner for any property covered by the inventories. Petitioner had no assurance as to what settlements finally would be made or that it ever would receive more than the then market value of the inventories. Up to the time of the partial

[5]The suspension requests were not in identical words, but in substance all were the same.

settlements in 1920, petitioner had no agreement that it would be paid the cost of any part of the property. Cf. *Lucas* v. *American Code Co.*, 280 U. S. 445, 449.

Petitioner's position was not different from that of a merchant whose stock on hand at the end of the tax year and not covered by contracts of sale had declined in value and was inventoried below cost. In such case amounts in excess of inventory value realized from sales in subsequent years are attributable to such years. Gains or losses must be accounted for in the year in which they are realized. The purpose of the inventories is to assign to each period its profits and losses. *Lucas* v. *Structural Steel Co.*, 281 U. S. 264, 268. The tax laws are calculated to produce revenue ascertainable and payable at regular intervals. Otherwise it would not be practicable to devise methods of accounting, assessment or collection capable of operation. *Burnet* v. *Sanford & Brooks Co.*, 282 U. S. 359, 365. The taking of petitioner's inventories at market value was essential to a proper disclosure of its financial position. Regulations in force at the time of the Commissioner's determination declare that items such as claims for compensation under canceled government contracts constitute income for the year in which they are allowed or their value is otherwise definitely determined. Regulations 65, Article 50. And see Regulations 45, Articles 1582-1584, as amended by T. D. 3296. On the facts found there was no warrant for including in petitioner's 1918 taxable income on account of such inventories any amount in excess of market value at the end of that year.

The lower court's dismissal of petitioner's claims for deduction of $327,937.35 on account of buildings and $500,473.19 on account of inventories cannot be sustained.

Reversed.

A true copy.

Test:

Clerk, Supreme Court, U. S.